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(22-26 April 1991)

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# I. MAIN FINDINGS AND RECOMMENDATIONS

## A. Medium-term outlook for the world economy

1. Even looking beyond the current recession in several major industrial countries, prospects for growth and the alleviation of poverty in most developing countries remain bleak. However, GDP growth is expected to remain high in many South and East Asian countries. In a great many other developing countries, especially in sub-Saharan Africa, growth in per capita output is expected to be negligible, or even negative. In the short term, the outlook for GDP growth in the world economy has been weakened by the expected continued decline in per capita output of many of the economies in transition in Eastern Europe and the Union of Soviet Socialist Republics and by the disruption caused by the crisis and war in the Gulf.

2. The generally bleak outlook could be greatly improved by better economic policies. At the international level, greater efforts are required to provide sufficient financial support to underpin the reform programmes of developing countries and of the countries in Eastern Europe and the USSR. Coordinated policy measures, including fiscal adjustment in a number of developed market economies, are needed to reduce real interest rates and to complete the resolution of the international debt crisis. The Uruguay Round of General Agreement on Tariffs and Trade (GATT) negotiations is in danger of losing momentum and needs to be brought to a satisfactory conclusion if the export prospects of developing countries are to be decisively improved. Effective economic policies in developing countries to encourage entrepreneurship, stimulate investment and expand exports need to be continued where they have recently been introduced and should be implemented by more countries. In sub-Saharan Africa, reform efforts by national governments need to be intensified and to be supported by improvements in both the volume and quality of the aid provided by developed market economies.

## B. Reforms in Eastern Europe and the USSR: impact on developing countries

3. While the pace and comprehensiveness of reforms will vary from country to country, the reform process will be long, since it involves wholesale changes in price relations, property relations, industrial structures and legal, commercial and financial institutions, encompassing the entire system of production and distribution. It is also expected to entail high social costs in the form of inflation and unemployment. The problems of the transition period will be exacerbated by a sharp contraction in regional trade due to the collapse of the Council for Mutual Economic Assistance (CMEA).

4. Depending on the pace and success of the reforms, a significant impact can be expected on exports from developing countries. In the medium to long term, the liberalization of trade and restoration of growth in the reforming countries will create numerous opportunities for export-oriented developing countries. Since it can be expected that the reforming countries will increase exports to the industrial countries, however, competition in the markets of industrial countries will intensify, since the majority of the exports of manufactures of both the developing countries and the reforming

countries are in the low and middle technological segments of production. A major expansion of exports requires substantial enhancement in productive capacities and production structures through capital formation, and policy and institutional reforms that might take a considerable amount of time; nevertheless, the competitive position of the reforming countries is expected to improve relatively rapidly because of an expected increase in direct investment by industrial countries in Eastern Europe which will enhance East European technology and marketing, and tariff reductions currently being negotiated by the European community with both Eastern Europe and the Soviet Union.

5. Eastern Europe and especially the Soviet Union have been a major market for the export of manufactures from a few developing countries such as Egypt, India, the Syrian Arab Republic and Yugoslavia. Based on special clearing arrangements, the exports of these countries are likely to decline, and they will have to search out markets elsewhere.

6. Several other countries, such as Cuba, Ethiopia, Mongolia, Mozambique and Viet Nam have had close economic relations with the Soviet Union and Eastern Europe involving large implicit subsidies in their mutual trade and have also received significant amounts of grant aid and technical assistance. The impact on these countries of the new trade regimes being put in place in Eastern Europe and the USSR and of their changed priorities in international relations is expected to be severe.

7. Until now, commitments of aid to Eastern Europe from the OECD Development Assistance Committee (DAC) have been additional to regular official development assistance (ODA) financing, but there have already been some derogations from the principle of additionality. It seems likely that in the future there will be further erosion of this principle and that some official finance provided to Eastern Europe will be at the expense of existing ODA budgets or will be financed from the growth portion of ODA.

8. There has been a proliferation of the policy conditions attached to aid to developing countries in the 1980s and this trend may be strengthened as the economic and political conditionality imposed on Eastern Europe will be seen as a precedent in donor relationships with developing countries.

9. With the opening up of Eastern Europe and the Soviet Union to foreign direct investment to various degrees, foreign direct investments to these countries increased briskly through 1990. But the magnitudes have not been so great as to constitute a significant competitive threat to the developing countries nor are they likely to attain such magnitudes in the short and medium term, particularly since large transnational corporations may view Eastern European markets as additional, and not alternative, investment opportunities.

10. German unification is expected to reduce the supply of German domestic savings to the rest of the world. This is expected to raise interest rates appreciably, thereby increasing developing country debt servicing burdens, and the cost of borrowing on international capital markets.

Conclusions for policy

11. In view of the high expected costs of reforms during the transition, the reforming countries of Eastern Europe and the Soviet Union will need extensive social safety nets for those affected and substantial support from the international community, without which the reform processes may not be fully successful.

12. To guard against adverse repercussions of changing directions of trade and increased competitiveness of Eastern Europe in the markets of industrial countries, developing countries need to put in place viable trade policies to strengthen their own competitiveness and to avail themselves of opportunities emerging in the reforming countries themselves.

13. For developing countries with substantial trade relations with Eastern Europe and the Soviet Union, it might be helpful if some barter, counter-trade and clearing arrangements were retained and phased out gradually.

14. In order to compete effectively for foreign direct investments with the Eastern European Countries, developing countries will have to improve domestic investment conditions, and invest adequately in the development of their human resources.

15. The donor community needs to ensure that official financial assistance to Eastern Europe continue to be based on the principle of additionality so as not to affect adversely financial support for the structural adjustment programmes and longer-term development programmes of developing countries.

16. Consideration should be given to special programmes of assistance for low-income developing countries experiencing severe adjustment problems as a consequence of economic and political changes in Eastern Europe and the USSR.

## C. International financial cooperation for development

17. In the 1980s, a general reduction in the inflow of real sources coincided with inadequate growth performance, low export revenues and a generally negative movement in the terms of trade, adversely affecting many developing countries. Moreover, mounting external debt servicing obligations reduced their capacity to finance domestic investments. Consequently, at the beginning of the 1990s, most developing countries - with notable exceptions - found themselves in dire economic and financial straits.

18. Given their reduced capacity to generate the levels of finance required to restore and maintain growth from their own resources, most developing countries needed substantial amounts of external long-term finance which, however, was not forthcoming. The overall picture turned out to be one of stagnation in real aggregate net resource flows and, more significantly, of negative aggregate net transfers to developing countries as a group for much of the decade.

19. Between 1981 and 1989, net official development finance (ODF), which includes ODA as well as the less concessional multilateral flows and certain bilateral flows, rose from 33 per cent to 63 per cent of total net resource

flows to developing countries, reflecting the virtual disappearance of commercial bank lending. ODA accounted for some 76 per cent of all official flows in 1989. In view of its preponderance, the evolution of ODA will be critically important in determining the overall level of official resources available to developing countries in the medium term. Unfortunately, while ODA increased in nominal terms in the 1980s, it was stagnant in real terms and among the DAC members the ODA/GNP ratio has remained stagnant over the past five years in spite of years of uninterrupted growth among OECD member countries. Moreover, there is certain to be a fall in aid from the USSR and Eastern Europe, as mentioned above.

20. Among policy makers in donor countries there has been a gradual acceptance of the need for debt cancellation under certain conditions as a necessary component of a comprehensive solution to the external debt problems of many developing countries.

21. While the decade of the 1980s was a lost development decade for many developing countries, it also saw the end of the Cold War, a heightened concern for the natural environment and a trend towards democratization in parts of the developing world. In industrial countries, the first has the potential to release net resources from military use to productive uses at home and abroad. Concerted efforts by the super-Powers in the future could prevent wars in the third world and release resources from their military expenditures there, and thus add to their development resources directly. The second - namely, the heightened concern for the restoration and maintenance of the natural environment - can also be harnessed to mobilize development assistance, particularly to combat the poverty that has become increasingly responsible for environmental degradation. The third, democratization, raises hopes for better governance but incipient democratic governments will find it impossible to accommodate rising expectations without economic growth, which for many will continue to require substantial external financial assistance.

22. Fiscal policy in the industrial countries has a pervasive impact on the volume and terms of resource flows to developing countries. Structural deficits reduce the volume of resources available in the form of international capital flows and increase the cost of borrowing costs on international capital markets; they raise the cost of capital, which leads to a slow down of growth in the industrial countries themselves, thereby reducing the demand for imports from developing countries; and they generate pressure for government spending reductions, from which official development assistance is not immune.

23. Many developing countries are engaged in serious domestic economic policy reforms, the central objective of which is to create an attractive economic environment which will encourage a high level of investment demand, enhance general economic efficiency, attract foreign capital for productive investment and discourage capital flight.

24. These policy packages include import liberalization and macroeconomic stabilization measures. Often the stabilization measures emphasize reductions in aggregate demand. However, imbalances in developing countries are often caused mainly by misdirected consumption, underproduction and inefficient production. Meaningful increases in domestic savings can only be generated through the reallocation of expenditure and the expansion of incomes.

25. Reforms in developing countries are unlikely to succeed without international financial support as well as increased and steady export revenues. Otherwise, the social and political cost of economic adjustment will cause reform programmes to break down.

26. In view of the emphasis on export-led growth in the economic reform programmes of many developing countries, the erosion of multilateralism in world trade through protectionism, voluntary export restraints, bilateralism and regional trading blocs poses major problems for the success of developing country economic reforms.

27. Perhaps a more important issue than the global volume of aid is its timeliness when needed and curtailment when it ceases to be productive. A closely related issue is the poor quality of existing ODA. Widespread aid tying continues to reduce its real value.

28. In the short term, the prospects for the weaker developing countries, especially those in sub-Saharan Africa and least developed countries elsewhere, are for increased dependence on ODA which is likely to reinforce the tendency to accept policy advice offered by donor countries and multilateral financial institutions. This is likely to shift further the responsibility for policy decisions in developing countries towards agencies involved in official development finance, which have been widely criticized for overlooking the short-run social and political costs of structural reforms.

29. In countries attempting economic reforms, increased resources through ODA and debt relief stand a better chance now of being efficiently utilized. Successful resumption of growth will in turn increase the ability of countries to generate savings as well as to attract and service private financial resources as needed and to gradually reduce their dependence on aid flows.

Conclusions for policy

30. In order to enable developing countries implementing structural adjustment programmes to bear the short-term costs of adjustment that threaten the sustainability of these programmes, there is an urgent need for additional assistance to them in the 1990s.

31. The utilization of a part of the "peace dividend" for development purposes should be supported by conscious and dedicated advocacy and promotion by interested parties in all countries.

32. Concerted efforts are needed on the part of the superpowers to prevent wars in the third world and to remove fears of threats to national sovereignty. If successful, this would benefit developing countries directly by enabling them to reallocate resources from military spending to development programmes.

33. The heightened concern for the environment expressed by the international community needs to be harnessed to channel development assistance to the poor countries that are unable to combat effectively the poverty and pollution that threaten international efforts to restore and maintain a healthy global environment.

34. In the short and medium term the recent trends towards democratization in the developing countries need to be supported by financial assistance to newly democratic governments so that they can meet expectations raised by political reforms.

35. A case exists for compensatory policies to correct for policy discrimination against free migration of labour from poor to rich countries.

36. In view of the tendency of the present generation in industrial countries, which attained maturity in the post-colonial era, to be less supportive of foreign aid, a coalition of interest groups within the industrial countries supportive of international development cooperation is needed for the mobilization of development assistance.

37. In implementing economic reforms, developing countries need to reconsider the pattern of public consumption and capital expenditure and the enhancement of efficiency in production. Decisive measures are needed to streamline and modernize the public sector, with care being taken to maintain investment in physical capital and human resources, especially as regards education and health. Stabilization policies should go hand in hand with supply-oriented structural policies, emphasizing overall economic efficiency.

38. Alongside efforts to raise the volume of development assistance, there is need for efforts to improve the quality and efficiency of aid, in terms of timeliness of disbursements, untying of assistance and redirection of assistance, for instance towards human resources development and institution-building at the community level.

39. In view of the rather bleak prospects for substantial enhancement of ODA in the immediate future, one effective way to increase resources available to the poorer developing countries is to remove their debt burden through significant cancellation of outstanding debt.

40. Further debt cancellation is needed to enable debt-distressed middle-income countries to regain credit worthiness at a level of imports adequate for the resumption of growth.

## D. Criteria for identifying the least developed countries

41. The Committee for Development Planning was divided over the usefulness of retaining the criteria for identifying the least developed countries, because donor countries often take into account quite different considerations in allocating aid. Despite such reservations, the Committee reviewed the criteria and revised them to better identify countries afflicted by poverty combined with severe structural weaknesses which impede the achievement of sustained development.

42. The Committee decided to retain per capita GDP as a measure of relative levels of poverty and to use two composite indices - one for human resource development and another for economic diversification, each comprising four indicators. The first includes the adult literacy rate, the combined primary and secondary school enrolment ratio, the daily per capita supply of calories and life expectancy at birth. The second includes the share of manufacturing

in GDP, per capita electricity consumption per year, the export concentration index and the proportion of the labour force in industry. In addition, the Committee decided to examine certain other relevant features of countries on a case-by-case basis. The Committee also decided to exclude from consideration new countries with a population size exceeding 75 million. On the basis of the above considerations, the Committee formulated rules for including countries in the list and for graduating them from it.

43. On the basis of the new set of criteria and the new inclusion and graduation rules, the Committee recommends that: (a) all the countries currently on the list be retained on it - except Botswana, for which it recommends graduation; (b) six new countries (Democratic Kampuchea, Ghana, Madagascar, Solomon Islands, Zaire and Zambia) be included in the list, bringing the total to 47 countries.

## II. THE WORLD ECONOMY 1/

44. Given the acute distress and anxiety created by the invasion of Kuwait, the world economy has shown greater resilience and stability than might have been expected during 1990 and into the beginning of 1991. The countries in the Gulf region were of course severely affected, as were many other countries which suffered a worsening of their balance of payments as a result of a decline in their exports to the Middle East and a reduction in remittances. None the less, the Gulf war caused less economic dislocation than many had feared. An increase in oil prices in 1990 proved to be lower than expected, with a compensatory decline in early 1991, so that major shortages and balance-of-payments shifts between oil importers and oil exporters were avoided. As anticipated in the 1990 report of the Committee, recession in some major industrial countries has increased unemployment. But the recession has remained relatively mild and is expected to peter out, with recovery likely to commence towards the end of 1991 and into 1992. Inflation is being held below 4 per cent for the most part. The growth of global trade is expected to be modest in 1991 but positive at some 4 per cent. In Eastern Europe and the USSR there was a sharp fall in per capita income in 1991 which is expected to continue for at least another year, but economic restructuring is now proceeding in several countries. Growth can not be expected for the moment, but a sharp improvement in economic performance may occur by the mid-1990s.

45. Developing countries continue to show widely divergent trends. Falls in per capita output are forecast in sub-Saharan Africa, parts of Latin America and in West Asia. Some countries, mainly in East Asia, have reduced growth from the double digit levels of the late 1980s to manage inflation and to ease social pressures, including unrealistic wage rise expectations that were running ahead of productivity. These countries are, however, still growing at 7 per cent per annum or more, so that they continue to double their income every 10 years. With strong growth-oriented policies for 30 years or more, the high growth and substantial poverty alleviation in these countries is not surprising. A number of countries that took major reform steps in the 1980s, such as Chile, Indonesia and Mexico, have also begun to grow rapidly. The reflection of outward, competitively oriented policies in rapid growth is hopeful for countries still engaged in the reform process.

46. Countries whose growth has been relatively modest, but steady, and which have avoided extremes of indebtedness are also showing that growth leads to substantial poverty alleviation. In India the proportion of people living in poverty has dropped from just under 50 per cent to just under 30 per cent in the past decade.

47. For many developing countries, however, the 1990s are proving to be no better than the 1980s. Rapid population growth still undermines what little economic progress is being made. Policy change continues to be slow. For those countries still relying on the export of one or two primary products for their foreign exchange earnings, the reflection of the industrial countries' recession in low prices for primary commodities creates budget and balance-of-payments difficulties. Thus for many sub-Saharan African countries, per capita growth is still negative.

48. The inability of the Uruguay Round negotiators to bring their discussions to a conclusion was a major disappointment in 1990. The international trading framework already in place will, of course, not be affected. Global trade continues to improve, because it has become evident to many countries that unilateral trade liberalization is also a useful policy tool, but the unilateral reform route is very slow. Protectionism by industrial countries has fortunately proved to be relatively porous, but it continues to impede trade. Vigilance, to avoid its extension and push it back wherever possible, is essential. The Uruguay Round introduced new and important issues into the international trade policy debate. Progress has been made on agricultural protectionism, the modification of the MFA and other issues. A successful conclusion to the negotiations is critical for international trade.

49. The divergence in economic growth is making it increasingly difficult to generalize about the global economy and about regional trends. As already suggested in our 1990 report, there is nothing in the global projections (table 1) that confines individual countries to regional trends. Countries can break out of stagnation. Their own policies are key to changing economic performance, although, of course, assistance can be helpful to policy reform. If enough countries followed such a course, the prospects presented in the projections could improve quite substantially by the end of the 1990s.

50. The outlook for the industrial countries is presented with caution. High growth rates are unlikely outside Japan. Some improvement on the projections presented may, nevertheless, be possible with the freeing of increased competitive forces by the European Community (EC) in 1992, greater integration between EC and the remaining West European countries and the greater integration of at least some of the East European countries into world markets. The restructuring problems in other East European economies may, on the other hand, create greater divergence in growth trends in Europe. Greater competitiveness and productivity prospects may also open up in North America.

51. Many Latin American and Caribbean countries are expected to have stronger growth in the 1990s than in the 1980s as their policy adjustments come to fruition. Costa Rica, Mexico and Venezuela are expected to recover adequate growth rates after their crises. Other countries such as Chile and Colombia are expected to maintain relatively steady growth. Policy changes in Brazil have yet to work their way through the economy. In a number of other countries in the region, policy reforms have not yet been effective so that sustained improvement still lies sometime in the future.

52. Political changes are complicating the task of economic management in South Asia. Hopefully, these are short-term problems, so that for the 1990s, the modestly successful economic performance of the past 20 years will at least continue, making further inroads into poverty, particularly in Bangladesh, India and Pakistan. If China can maintain its current growth rate, it too will be able to take substantial steps towards poverty alleviation and the improvement of living standards.

53. The newly industrializing and "second tier" newly industrializing economies of East Asia are reaping the benefits of early and sustained macroeconomic and micro-economic policy reform. One or two of these economies may bypass lagging industrial countries by the end of the 1990s. But not all East Asian countries are thriving. The Philippines' legacy of debt is still

Table 1. Annual change in world GNP

(1970 United States dollars)

| Country/area | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | Mean |
|---|---|---|---|---|---|---|---|
| World total | 1.2 | 0.9 | 2.9 | 2.9 | 3.4 | 3.4 | 2.4 |
| Developed market economies | 2.4 | 1.7 | 3.0 | 2.7 | 2.8 | 3.0 | 2.6 |
| North America | 1.0 | 0.9 | 3.1 | 2.7 | 3.0 | 3.0 | 2.3 |
| United States | 1.0 | 0.9 | 3.1 | 2.7 | 2.9 | 3.0 | 2.3 |
| Developed East | 4.8 | 3.4 | 4.3 | 3.9 | 4.0 | 3.6 | 4.0 |
| Japan | 5.7 | 3.4 | 4.6 | 4.0 | 4.0 | 3.7 | 4.3 |
| European Community | 3.5 | 2.1 | 2.6 | 2.3 | 2.2 | 2.6 | 2.6 |
| Germany (Federal Republic of) a/ | 4.5 | 2.7 | 2.2 | 1.7 | 1.6 | 2.3 | 2.5 |
| France | 2.7 | 2.1 | 3.1 | 3.3 | 3.0 | 3.2 | 2.9 |
| United Kingdom | 0.9 | -0.8 | 2.5 | 1.9 | 2.2 | 2.8 | 1.6 |
| Rest of industrialized | 1.2 | 0.4 | 1.8 | 3.0 | 3.1 | 3.9 | 2.2 |
| Developing countries | 2.7 | 3.7 | 5.1 | 5.1 | 5.3 | 5.4 | 4.6 |
| Latin America and Caribbean | -1.1 | 1.5 | 3.8 | 4.4 | 4.6 | 4.6 | 3.0 |
| Argentina | -2.1 | 1.6 | 1.5 | 1.4 | 1.7 | 2.0 | 1.0 |
| Brazil | -4.9 | -0.9 | 4.2 | 5.5 | 5.7 | 5.5 | 2.4 |
| Mexico | 2.6 | 3.4 | 4.6 | 5.2 | 6.0 | 5.8 | 4.6 |
| Venezuela | 4.4 | 5.3 | 5.2 | 3.9 | 1.3 | 3.4 | 3.9 |
| Africa | 2.9 | 2.8 | 2.6 | 2.3 | 3.2 | 3.3 | 2.9 |
| North Africa | 2.8 | 2.9 | 2.3 | 2.1 | 3.3 | 3.2 | 2.8 |
| Algeria | 4.6 | 4.6 | 2.9 | 3.4 | 4.1 | 4.2 | 4.0 |
| Egypt | 1.3 | 1.7 | 1.2 | 1.1 | 2.5 | 2.2 | 1.7 |
| Sub-Saharan Africa | 3.0 | 2.8 | 2.9 | 2.5 | 3.2 | 3.4 | 3.0 |
| Nigeria | 4.9 | 4.1 | 2.7 | 2.0 | 3.8 | 4.0 | 3.6 |
| South-East Asia | 5.8 | 5.5 | 6.0 | 6.1 | 6.2 | 6.2 | 6.0 |
| Hong Kong | 2.6 | 4.0 | 5.5 | 5.6 | 5.1 | 4.7 | 4.6 |
| India | 4.4 | 3.9 | 4.8 | 5.2 | 5.4 | 5.4 | 4.8 |
| Indonesia | 6.5 | 7.1 | 7.7 | 7.3 | 7.6 | 7.7 | 7.3 |
| Republic of Korea | 9.0 | 7.8 | 7.8 | 7.8 | 7.8 | 7.3 | 7.8 |
| Taiwan Province | 5.1 | 6.9 | 6.5 | 6.0 | 6.1 | 6.1 | 6.1 |
| Thailand | 10.0 | 7.3 | 6.8 | 7.3 | 7.6 | 7.9 | 7.8 |
| China | 5.0 | 5.7 | 6.3 | 6.3 | 6.4 | 6.4 | 6.0 |
| West Asia | -6.5 | -7.9 | 8.8 | 6.1 | 6.3 | 6.6 | 2.0 |
| Oil-exporting countries | -8.2 | -11.1 | 10.6 | 7.1 | 7.4 | 7.7 | 1.9 |
| Oil-importing countries | 1.2 | 4.7 | 2.6 | 2.4 | 2.4 | 2.4 | 2.6 |
| Mediterranean | -1.4 | 1.8 | 4.1 | 2.7 | 2.4 | 3.3 | 2.1 |
| Eastern Europe and the USSR b/ | -5.6 | -6.6 | -1.1 | 0.2 | 3.1 | 2.7 | -1.3 |
| USSR | -4.8 | -5.1 | -1.0 | -0.1 | 2.3 | 1.9 | -1.2 |

Table 1 (continued)

| Country/area | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | Mean |
|---|---|---|---|---|---|---|---|
| Memo | | | | | | | |
| Germany c/ | 3.4 | 0.3 | 1.8 | 1.7 | 2.0 | 2.6 | 2.0 |
| Eastern Europe a/ | -6.8 | -3.1 | -0.5 | 1.0 | 4.6 | 4.1 | -0.2 |
| Developing countries (excluding China) | 1.9 | 3.0 | 4.6 | 4.7 | 4.9 | 5.0 | 4.0 |
| Least developed countries | 1.9 | 1.7 | 2.7 | 2.4 | 2.5 | 2.8 | 2.3 |
| Net energy-exporting countries | 3.8 | 4.5 | 5.6 | 5.5 | 5.8 | 5.9 | 5.2 |
| Net energy-importing countries | 1.6 | 3.0 | 4.6 | 4.7 | 4.9 | 5.0 | 4.0 |

a/ Excludes the former German Democratic Republic.

b/ Includes the former German Democratic Republic.

c/ Former Federal Republic of Germany plus former German Democratic Republic.

causing serious economic problems. Viet Nam, Cambodia and the Lao People's Democratic Republic remain victims of war and are among the poorest countries in the world.

54. The worst prospect, yet again, is for Africa, and within Africa, for sub-Saharan Africa. Only a handful of African countries have been able to pull their economies out of the depths that mean a short and deprived life for the majority of the population. Botswana is noteworthy for having taken advantage of its natural resource endowment to move towards rapidly rising living standards.

55. The faces of the victims of the famines that no data can even begin to describe haunt us all. It is not enough to record the past and the likely future once again. Although special attention has been given to sub-Saharan African countries, the results have been meagre. Financial assistance, even when supported by vast numbers of advisers, has not succeeded in accelerating growth. The donor community as well as the countries themselves need to analyse their policies. Intelligence as well as compassion is needed.

56. Fear of inflation and large structural deficits are maintaining relatively high interest rates in a number of industrial countries, raising the cost of borrowing for the reforming centrally planned economies and developing countries. Compared to their real capital costs and to returns on major projects, present interest rates are still manageable, but the servicing of debt is costly. Great prudence has to be exercised in new borrowing. High interest rates exacerbate fears that developing countries would be "crowded out" by the reforming centrally planned economies. As is discussed in

chapter III, enormous transfers from western Germany to eastern Germany are likely to continue to exert upward pressure on interest rates. None the less, the multilateral financial institutions have been able to provide support simultaneously for major developing countries and for East European countries. Private direct foreign investment flows are still largely determined by the economic policies of the host countries, with reinvestment of profits playing an important role in the growth of production. The caution recently exhibited by leading banks was a reaction to excessive careless lending in the 1970s and 1980s and a weakening of the capital base of several major banks, rather than a global shortage of capital. A better balance between the propensity to save and the propensity to consume is essential in industrial countries if they are to provide markets for developing country exports as well as sources of capital for developing countries. The problem of scarce capital arises mainly in aid funds although they continue to grow roughly in proportion to industrial country GDP.

## III. REFORMS IN EASTERN EUROPE AND THE USSR: THEIR IMPACT ON DEVELOPING COUNTRIES

57. Dramatic economic and political changes are taking place in Eastern Europe. These reforms have been the subject of extensive comment and analysis, including studies by the Commission of the European Communities, International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD), OECD, European Bank for Reconstruction and Development (EBRD), and the European Economic Community (EEC). Little attention however has been paid so far to the external effects of the reforms in Eastern Europe. At the same time, there are fears, especially in developing countries, that these reforms may have harmful consequences on other countries. The Committee for Development Planning therefore decided to examine this topic in some detail.

58. In judging the impact of the reforms in Eastern Europe on other countries, a distinction has to be made between the long-term effects and the impact during the transition period.

59. Assuming that, despite the present difficulties, the reforms are ultimately successful, in the long term the consequences for the developing countries almost certainly will be positive. After successful reform and a resumption of economic growth, Eastern Europe will become a large export market for the developing countries and a potential source of capital and technology. Growth generates growth, and consequently the long-term impact will be beneficial for all countries. The same is likely to be true for the political effects. If democracy becomes well established in Eastern Europe and the USSR, this may well have a favourable impact on processes of democratization in some developing countries.

60. Less easy to determine is the impact on developing countries during the transformation process, in the short and medium term. The immediate outlook is for an adjustment process that may last several years and be accompanied by inflation, a fall in production and growing unemployment. This in turn may have some harmful consequences for third world countries, or so it is feared.

61. The Committee's analysis concentrates on the possible effects on trade, commercial capital flows, official capital flows and private foreign investment. Our broad conclusion is that the effects of reforms in Eastern Europe and the USSR on the developing countries as a group in these four areas is likely to be negligibly small. Official capital flows to countries of Eastern Europe and the USSR and to developing countries each have their own "constituency" and are competing with each other only to a very limited extent. Private foreign investments are decided on a case-by-case basis, and each project is considered on its own merits; balancing investment in Eastern Europe against investment in developing countries is a marginal factor in this process. Commercial flows are characterized by similar considerations. In the field of trade, shifts may take place, but this is likely to occur only in the long run and developing countries should have ample opportunity to adjust their economies to exploit any new comparative advantages that may arise. Foreign aid from Eastern Europe and the USSR to the developing countries will fall sharply, but only a few countries, such as Cuba, Ethiopia, Lao People's Democratic Republic, Mongolia and Viet Nam, are likely to be seriously affected.

62. It should be noted, however, that the reform processes in Eastern Europe and the USSR are surrounded by a considerable degree of uncertainty as regards specific goals and strategies. Consequently, this report is somewhat speculative in character. None the less, these uncertainties are not thought to be of such a magnitude as to undermine our general conclusions.

## A. Reforms in Eastern Europe and the USSR: overview

63. Conceptually, the problems of the transition can be classified under three different headings. One stems from the legacies of the central planning environment. A second derives essentially from problems of framing and implementing policies intended to transform one economic system into another. There are also problems that arise because of unanticipated changes in the external environment.

### 1. Legacies of central planning

64. The countries of Eastern Europe and the Soviet Union have known central planning for between 40 and 60 years. The basic foundations of a market economy are missing. This includes the technical instruments for intermediation in a market environment, such as a commercial banking structure, and the legal instruments which constitute the very foundations of a pluralistic society, such as a well-developed body of civil and commercial laws.

65. Central planning has traditionally resorted to administrative coordination, chiefly through instruments other than those typical of a market economy. Instruments for indirect economic coordination among economic agents are very different in a market environment from those typically embraced by a central planning system. This is especially the case at the level of the firm, where managerial styles will have to be rapidly transformed. It is also true to some degree at the level of the household, especially in determining choices between consumption and saving and between leisure and work.

### 2. The starting conditions for reform

66. Given the absence of the fundamental elements of a market system, policy makers managing the process of transition towards reform must put these components in place as quickly as possible. These foundations cannot of course be imposed from above. Instead, they must be created and accepted organically through the newly emerging political structures. Negotiating the key components of a new society and economy inevitably takes time and effort.

67. One of the legacies of central planning is an economic structure that does not reflect the relative scarcity of resources as valued in world markets. Relative prices are distorted, often not having been changed for decades, and they diverge considerably from world prices. Trade and price liberalization, both desirable components of market-oriented reforms, will necessitate major structural adjustments, and those are bound to entail social costs. These costs are likely to take the form of rising inflation and high unemployment.

68. One key problem is to create a consensus as to the costs of transition that can be tolerated by society, the speed at which the cost can be absorbed, and the most equitable way to distribute the cost among the members of society. Prolonging the transition period may entail greater costs. One particular problem arises from the effects on investment and growth of uncertainty as to whether the former owners of private property will have their property restored or merely receive partial compensation. It is by no means clear whether these problems can be resolved quickly and in a way that does not undermine support for the reform process itself.

69. The countries of Eastern Europe and the USSR lack a managerial culture that would enable them quickly to shift towards market-type decision-making. This applies not only to the day-to-day management of enterprises but also to questions related to the exit and entry of firms in a market environment. Wealth accumulation has typically been limited to cash, savings or government bonds. Households have been accustomed to extensive social protection as consumers and workers for more than two generations. People expect this protection to remain, and at the same time they expect to benefit in terms of greater wealth, higher incomes and greater availability of goods and services after moving towards a market economy. These two sets of expectations may not always be compatible. Furthermore, egalitarian ideals are deeply rooted in the reforming societies, and these may make it difficult to introduce significant income differentials and to accept a transparently unequal distribution of wealth.

### 3. The external economic environment

70. There are three key issues that concern the external economic environment. One is the external payments problems that are endemic in the former centrally planned economies. These problems are now being aggravated by a sequence of unexpected developments. Among them, the most prominent is the collapse of the Council for Mutual Economic Assistance (CMEA) as a regional economic organization and as a framework within which the vast bulk of their trade and payments were made. (In 1989, the European members of CMEA conducted 40-80 per cent of their trade among themselves.) The replacement of transferable rouble prices by world market prices as well as the replacement - in principle - of transferable rouble settlement arrangements by convertible currency payments led to a dramatic contraction in the volume of trade. Furthermore, there is as yet no coherent framework that has replaced the arrangements formerly available from within the transferable rouble system, however bilateralized that system traditionally has been. Trying to maintain key trade flows through various ad hoc payments arrangements, in some cases resorting to strict barter trade, merely complicates matters.

71. The unsettled state of the Soviet society and economy, and the uncertainties surrounding the reform process itself, are complicating the transition in the countries of Eastern Europe, if only because the Soviet Union has traditionally been their key trading partner.

72. Trade within CMEA was conducted at highly distorted prices. Eastern Europe has been critically dependent on the Soviet Union for its fuel and raw material supplies. The disruption of this trade has resulted in adverse terms of trade and income effects among former members of CMEA. Matters have been

further complicated by the rise in world oil prices. It further worsens the terms of trade of those countries importing fuel, although the Soviet Union could be a major beneficiary, provided it can maintain high levels of exports of fuel.

73. The reform processes in Eastern Europe and the USSR seem to have led so far to the following tentative conclusions:

(a) The basic conditions in the reforming countries differ widely in terms of size of country, ethnic composition, political constellation, and economic history. These differences require tailor-made solutions; few if any general prescriptions will apply;

(b) Reform processes require changes in attitude, the development of entrepreneurship, the drafting and implementation of legislation, and overhaul of the tax system, and the building of new institutions such as financial markets and trading systems, all of which are complicated and take time. Consequently, the reform processes are likely to require many years instead of months;

(c) Withdrawal of the State from the economic scene, in combination with political liberalization, threatens in the short run to create economic chaos and to foster ethnic disturbances rather than economic growth and political democracy;

(d) The reform processes may result in a breakdown of existing economic and social systems before new systems are put in place. If this were to occur, a fall in output and incomes and a rapid increase in unemployment would be the consequences. In order to prevent political and social unrest and to overcome opposition to reform, the reform process will have to be supported from the beginning by social safety nets;

(e) Measures to transform the structure of the economy will not succeed without a restoration of macroeconomic stability. The latter requires, in particular, adjustments in fiscal, monetary and exchange rates. However, the idea of two distinct phases - stabilization first, transformation second - is too simple since, in practice, stabilization measures will also be necessary during the process of transformation;

(f) There is a distinct difference between privatization and commercialization. Privatization is concerned with the transfer of ownership of the means of production; commercialization implies that production and distribution are based on liberalized prices and on market incentives. Privatization without commercialization serves no useful purpose, whereas commercialization without privatization could be possible if State enterprises are subject to competitive forces;

(g) The collapse of CMEA and the hasty switch from a centralized command economy to a decentralized market economy has resulted in a drastic decline in trade. This fall was aggravated by the disarray in the Soviet economy. However, some of the reduction was in non-economic trade;

(h) Political and ethnic problems in the USSR, Yugoslavia, Romania and Bulgaria have brought their reform programmes to a standstill and have created an atmosphere of gloom regarding the outcome of the reform processes in general. However, in the countries where reform processes are well under way - despite enormous difficulties - impressive successes have been achieved, as witnessed, for example, by the increase in exports to developed market economies by Hungary and Poland.

## B. Impact on developing countries

### 1. Trade prospects 2/

74. Radical economic reforms in Eastern Europe and the Soviet Union could entail a significant impact on exports from developing countries. The actual impact of these new reforms will depend on the success of the former centrally planned economies in creating a transformed economic system, by itself a complex and stressful process that will take many years to be successfully concluded. In the medium to long term, however, it is expected that the liberalization of trade and restoration of growth will create numerous opportunities for export-oriented developing countries.

75. In the short run, import demand in Eastern Europe and the USSR is likely to remain weak. In countries such as Czechoslovakia, Hungary, and Poland there is de facto currency convertibility for current transactions. But since a large portion of foreign exchange is siphoned off by debt service, the cost of foreign exchange is high and discourages imports, despite significant import liberalization. In other countries, balance-of-payments constraints and falling output are expected to lead to some contractions of imports.

76. Whatever the pace of economic reforms, the change in trading behaviour of Eastern European and Soviet enterprises can come about only slowly, because habits that evolved in the past are hard to eliminate. Moreover, a major expansion of exports and modifications in their product structure requires substantial enhancement in productive capacities through capital formation that might take a considerable amount of time.

77. The question to be answered is whether the totality of change in trade by Eastern Europe and the Soviet Union will produce at the end a pattern of trade that is similar to that of the industrial countries or to that prevailing in the developing world. This is a difficult question because Eastern Europe shares many commonalities with both the industrial economies and developing countries.

78. The countries of Eastern Europe and, to a lesser degree, the Soviet Union are rapidly shifting their exports to the markets of industrial countries, particularly Western Europe, and this trend will continue. In 1990, for example, the value of goods exported by Hungary and Poland to developed market economies increased by 21 and 40 per cent, respectively. This means that exporters from the developing nations will face stiffer competition in those markets, particularly because the majority of their exports of manufactures are in the low and middle technological segments of production.

79. The competitive position of East Europe relative to the developing countries will be strengthened by a rapid increase in direct investment by industrial countries that will enhance East European technology and marketing and at the same time reduce the amount of capital available to developing countries. The competitive position of Eastern Europe and the USSR in the markets of industrial countries will also improve slightly relative to the developing countries because of the tariff reductions being negotiated by the EC with both Eastern Europe and the Soviet Union.

80. In some products, however, producers from Eastern Europe and the Soviet Union are at such a great disadvantage on the markets of industrial countries that even after the recent changes in the region, it will be very difficult to compete against exports from developing countries (e.g., clothing, some consumer electronics, microprocessors). In other segments, the chances for Eastern Europe are good, particularly in capital goods (e.g., machine tools, construction machinery), where many developing countries are just beginning to develop export capabilities.

81. The countries of Eastern Europe have never penetrated very deeply into the markets of developing countries, and their low share of trade has been declining during the past several years. It is unlikely that this situation in either Eastern Europe or the Soviet Union will change soon. They have to face stiff competition in those markets from the industrial countries and increasingly from rapidly growing, newly industrializing developing nations.

82. The major obstacle to a substantial acceleration in exports to developing countries is that Eastern Europe and the Soviet Union have allowed their production of manufactures to fall technologically behind many developing countries, especially those with export-oriented economies.

83. The recent breakup of the CMEA, combined with political developments in the region and falling supplies of petroleum from the USSR, have resulted in a rapid reduction in trade among its members. This could provide the developing countries with an opportunity to export more aggressively to the region, especially for neighbouring countries and those exporting oil and some other primary commodities. However, in the medium term the reduction in intra-regional trade may not be as dramatic as the current shift suggests.

84. The imports from developing countries are increasingly based less on political considerations and more on economic ones. The choice of partners and product selection is becoming more subject to economic calculus. Consequently, there will be a shift in imports from economically less successful formerly allied countries (e.g., Cuba, Viet Nam, Ethiopia) to other more dynamic and flexible developing economies (e.g., China, Republic of Korea, Taiwan Province).

## 2. Official capital flows

85. It is not possible to measure precisely the commitments of foreign aid to East European countries in the 1989-1991 period. Commitments have been made with varying time periods, and certain pledges of assistance have been made, conditional upon reform continuing in the Eastern European countries. The

situation evidently is very fluid, and it is impossible to measure official aid commitments to Eastern Europe.

86. With these caveats in mind, the European Commission estimates that developed market economies have commitments, including the capital subscriptions to the EBRD, to Eastern Europe (including Yugoslavia) and the USSR for the period 1990-1992 equal to ECU 27.6 billion. This is equivalent to $42.64 billion. 3/

87. If these flows are to be additional to official resource flows to developing countries, DAC member countries and other donor agencies would have to maintain, at a minimum, their current relative share of GNP devoted to official net resource transfers to developing countries. In fact, DAC member Governments made the following commitment at their DAC high-level meeting in late 1989:

> "Member Governments recognize the importance of the fundamental political changes in Central and Eastern Europe and will support the important process of economic reform in these countries. This support will not diminish their determination to give high priority to their development cooperation with the Third World." 4/

88. In order to reinforce a commitment to the principle of additionality, it appears that official aid to Eastern Europe and the USSR will not in the immediate future be counted as ODA or even reported by the DAC. There will be separate reporting and recording of these flows to maintain the distinction from traditional ODA.

89. To date, DAC commitments to Eastern Europe and the USSR have been additional to regular ODA financing. There have been some modest derogations from this principle which arguably may be the thin edge of the wedge. Many observers believe that in future there will be a further erosion, as more and more financing destined for Eastern Europe and the USSR will have to come at the expense of the existing ODA.

90. For example, the Swedish Parliament approved the allocation of SKr 1 billion (about $200 million) over the three years 1990-1993 to Eastern Europe for support of democratic development and the economic reform process. These funds were allocated from the growth portion of Swedish ODA which, as a proportion of GNP, remains among the very highest of DAC members. It has also been reported that in the Netherlands, another strong supporter of ODA, some funds were reallocated from traditional ODA finances to match private humanitarian assistance to Eastern Europe in 1990.

91. These examples are symptomatic of the type of encroachment which may well emerge over the next five years. Although limited to the more generous ODA donors in these examples, it is not beyond reasonable doubt that other, less generous, donors may also turn to the nominal "growth" portion, or even existing levels, of ODA to finance programmes in Eastern Europe. In response to this concern, in mid-1990 Italy proposed that European Community donors raise the value of their global aid to 1 per cent of GNP by 1993. Italy proposed that half of this "new" aid be allocated to Eastern, central and southern European countries.

92. A second issue concerns policy conditionality and whether the economic and political changes in Eastern Europe will encourage additional policy conditionality or new forms of conditionality in official financing policies for developing countries.

93. Attaching policy conditions to development financing has a longer history than the recent changes in Eastern Europe. Donor country and multilateral financial institutions have for some time been concerned with the effectiveness of aid efforts and the emergence of severe macroeconomic imbalances, particularly in the least developed countries. These concerns have led to increasing aid conditionality throughout the 1980s.

94. Policy conditionality has not only involved more donors and recipients in the past decade; it also has evolved to encompass a wider range of policy issues. Some donors used policy conditionality to urge the inherent wisdom of market-oriented allocations of resources as the sine qua non of successful development. Some donors wanted to ensure respect of environmental integrity or respect for human rights or for womens' participation in development. Whatever the motivation on the part of donor countries, there is little doubt that increased conditionality pre-dated the events in Eastern Europe in late 1989. It is the official policy of donors with respect to flows to Eastern Europe and the USSR that the allocation of multilateral financing through the EBRD and the European Community as well as many bilateral programmes for the East European region will be conditional upon economic and political reform in those countries. For example, both the charter of the EBRD and the EC's PHARE programme for Eastern Europe are predicated upon the reform movement maintaining momentum in these countries.

### 3. Commercial capital flows

95. Except under special conditions, few, if any, banks contacted in a special survey appear to be interested in participating in fresh medium- and long-term sovereign lending to Eastern European countries for infrastructure or balance-of-payment purposes.

96. Both the political and economic situation are viewed as highly unsuitable, particularly in the Soviet Union, for which banks (mostly in Europe) have recently increased provision levels for existing exposures by a considerable margin. Although provision levels for exposure to the Soviet Union are not disclosed, analysts believe that they currently run as high as 75 per cent for the more conservative European banks. Accordingly, there is little likelihood that banks will increase their direct unsecured medium- and long-term lending.

### 4. Foreign investment 5/

97. In the second half of the 1980s, conditions for foreign investment in Eastern Europe changed dramatically. The failure of the USSR to follow the lead of its smaller allies had served as a brake on their foreign investment policies. That brake was removed when the Soviet Union announced in 1986 that it would permit foreign capital participation in joint enterprises on Soviet territory as of January 1987.

98. The accession of the Soviet Union to the ranks of socialist economies open to foreign investment was of great intrinsic importance to the evolution of relations with foreign investors, because of the Soviet economy's size and resource endowments. It was also of major symbolic significance, adding the oldest, as well as largest, economy of the area and one that had served as a prototype for the others. The Soviet decision had clearly been influenced by the relative success of the Chinese experience with foreign investment. It was Soviet perestroika, the general climate of political and economic reform in the Soviet Union, however, that served as the immediate catalyst for the Soviet decision.

99. In taking this decision, the Soviet leadership explicitly recognized the importance to the future development of the Soviet economy of direct ties to the world economy at the enterprise level. Equity partnerships were to play a central role in these new, "organic" linkages. These new partnerships were to serve as channels through which not only technology, but also foreign goods and services and foreign organizational and commercial know-how could, on a broad scale, assist the Soviet economic and institutional restructuring. This represented a major shift in approach, away from the centrally planned, highly selective acquisition of foreign technologies, which was regarded as no longer sufficient to Soviet needs.

100. A second major boost to the development of East/West investment relations came in Eastern Europe in 1989 with the events that reached a climax in the final months of the decade. The collapse of old regimes throughout the area broke the long-standing political barriers to significant reform. The result has been the initiation of a course widely proclaimed as a "transformation" of Eastern European societies. In the domain of economic systems, transformation involves the twin processes of marketization and privatization. These hold out the promise to foreign firms of the creation of institutional conditions whose prior absence had been a long-standing deterrent to investment in the area.

101. These basic policy developments were accompanied by various measures to strengthen incentives and guarantees, including the negotiation of bilateral investment protection treaties. The Soviet Union, for example, has signed such agreements with Austria, Canada, Finland, France, Germany, and the United Kingdom, and negotiations with the United States are in progress.

102. In the earlier years, when the private sectors of the economies of Eastern Europe and the USSR were severely restricted and essentially marginalized, foreign capital participation under joint venture arrangements was anomalous. Attempts to accommodate it often took the form of treating foreign investment activities as a kind of enclave within the host economy, subject to different regulations and separated by special controls. Now, as State enterprises are transformed into joint stock companies under new laws of incorporation and are privatized, foreign investment can be accommodated in ways which greatly enhance its potential. Thus, it is not surprising that the reforms have already increased investment flows to the area, especially to those economies that have advanced the furthest along the path of transformation.

103. The countries of Eastern Europe and the USSR now offer a range of institutional possibilities for foreign direct investment comparable - albeit as yet, less developed - to those found in developed market economies; the Soviet Union lags behind in this regard. The area as a whole now offers not only majority holdings in jointly created enterprises to foreign investors but also the possibility of setting up wholly owned subsidiaries. In Eastern Europe, with Hungary in the forefront, there is also the increasing possibility of acquiring a stake in existing enterprises that are being reorganized and privatized, even to the extent of 100 per cent ownership.

104. The changing ownership structure in Eastern Europe is also broadening the spectrum of potential partners for Western investors. State enterprises are no longer the sole option; and among the growing alternatives are private firms and banks, cooperatives and joint enterprises. The Czechoslovak Ministry of Finance reported, in January 1991, that State enterprises participated in only 10 per cent of the joint ventures for which it issued permits in the second half of 1990.

105. It should be noted that the reorganization of State enterprises has also opened up the possibilities for portfolio investments in Eastern Europe. For example, shares of the Hungarian State travel and tourism company, Ibusz, are now being traded on the Vienna Stock Exchange. Investment funds have been created in Europe, North America and Japan to take advantage of these new possibilities and Western interest in them. These include the First Hungary Fund, the Austro-Hungary Fund, the Hungarian Investment Company, First Europe Capital Fund and the Central European Development Corporation.

106. Other things such as political and economic conditions being equal, Eastern Europe offers three important advantages as a locus for Western direct investment. Its geographical proximity makes it an ideal location from which to serve West European markets. Its European traditions and historic links to Western Europe facilitate mutual understanding and interpersonal relations at the operating level (despite the absence as yet of a Western business culture). Its educated population offers a technically skilled, and as yet relatively low cost, labour force. The rapid expansion of foreign direct investment into the automotive industries of Eastern Europe illustrates the readiness of Western firms to incorporate these considerations into their strategic planning.

107. The number of joint venture investments has grown rapidly since 1987. In Central Europe, there was a burst of investment activity in 1990. In the Soviet Union, the peak was reached in 1989 and the rate of registrations fell off rapidly in 1990, especially in the second half of the year.

108. By the end of 1990, the estimated number of joint ventures registered in the four countries exceeded 10,000. It should be noted, however, that:

(a) Many of them were small. The average value of investment in joint ventures in the Soviet Union is estimated at $1.5 million, the average in Central Europe is less than a third of that ($370,000). There is a strong investor inclination towards the service sector, where initial capital outlays are not so great;

(b) The figures represent commitments rather than actual transfers of funds. Many of the joint ventures were not yet operational or had ceased operation.

109. The capital requirements of Eastern Europe's transformation are difficult to estimate. Rates of investment have traditionally been high. Now State expenditures are being shifted to other purposes (consumption, social welfare). Yet the requirements needed to bring the industrial structure of these countries into line with international technical and environmental standards are potentially enormous. The head of the Hungarian State Property Office is quoted as estimating the value of his country's State-owned industrial enterprises at about $32 billion and of the 400 scheduled to be denationalized in the next four years at $8 billion. An upper bound is perhaps set by a report by the Centre for Economic Policy Research in London, which estimates at $135 billion per year the value of physical capital needed for six East European economies (Bulgaria, Czechoslovakia, the former German Democratic Republic, Hungary, Poland and Romania) to double their GDP in 10 years. The report notes that this task is now to be left to an unprecedented degree to private, especially foreign, capital.

110. The need for major inflows of foreign direct investment capital are therefore strong. The investor response seems unlikely to match them, at least in the short and medium term.

111. During the next two years (1991-1992), it is not clear that the initial (1989-1990) response will be sustained. There may even be a decline in flows of investment to the area. The data suggest that this may already have begun in the Soviet case. The events of 1989-1990 stimulated a euphoric burst of optimism and enthusiasm. A survey of 130 large multinational firms carried out in September 1990 indicated that a large majority had been quick to take account of developments in Eastern Europe and the USSR and to include the area in their long-term investment planning. The initial euphoria and the favourable business climate it engendered have now begun to wear off. The new mood is reinforced by greater awareness of the practical difficulties posed by investment in the area. In the case of the Soviet Union, caution is heightened by mounting political uncertainty and increasingly restrictive government measures. In the case of Eastern Europe, it is the prospect of a deepening economic crisis and its possible political repercussions that has dampened investor enthusiasm. The large decline in the aggregate output of the area as a whole that occurred in 1990 is generally expected as likely to continue in 1991-1992. Moreover, a number of the more attractive opportunities for investment (especially in the form of acquisitions) will have been taken. Finally, the unexpectedly rapid unification of Germany in 1990 has served to concentrate western German investor attentions on eastern Germany and away from Eastern Europe.

112. In the best of circumstances, one could not have expected a reorientation of Western strategic business planning, and the realization of major investments in a new area, in less than a few years. Eastern Europe, moreover, has not offered the best of circumstances. How quickly the investment climate will improve depends upon the stability of new political regimes and their success in carrying out economic stabilization programmes combined with institutional reforms. In particular, it will hinge on how

quickly privatization programmes will get under way and how extensive they will be.

113. Over the period 1992-1995, greater differences will probably emerge among the Eastern European countries. Some are likely to progress faster than others, and the investor response will accordingly be increasingly differentiated. In particular, if the present crisis continues to immobilize reform in the Soviet Union, there will be increasing investor inclination towards Eastern Europe. For all of its advantages of size and natural resources, the USSR will not succeed in developing a significant relationship with foreign private capital until there is a demonstrated commitment to replacing the old administrative command mechanism with a market-oriented system having an important role for private ownership.

114. Barring major internal political setbacks, and in reasonably favorable international circumstances, including significant economic assistance from developed market economies, the outlook for the area in the period 1996-2000 is much more positive. The region's privatization drive is likely to require at least a decade to produce results. By that time, the USSR could be expected to have laid the political and constitutional foundations for more rapid progress towards the economic goals that it has set for itself. A real economic "take-off" for the area, fuelled by foreign investment, is conceivable by the end of the decade.

115. As regards the potential for diversion of foreign direct investment from developing countries to Eastern Europe and the USSR, the current size of the resource flows should be put in perspective. One might estimate the inflows of FDI to Czechoslovakia, Hungary, Poland and the USSR at nearly $2 billion in 1990. IMF data show foreign direct investment inflows world wide at about $182 billion in 1989. Of this, about $18.5 billion was to the developing countries. Inflows of FDI to China in 1989 were reported at $3.4 billion.

116. The evidence thus suggests that the magnitudes of FDI flows to Eastern Europe and the USSR, while having increased dramatically through 1990, are not yet great enough to constitute a significant competitive threat to the developing countries. Nor are they likely to attain such magnitudes in the short and medium term.

117. It is in any case questionable whether Western firms, especially large multinationals, approach Eastern Europe as an alternative rather than as an addition to investments in the developing countries. These investments tend to be viewed as serving different strategic purposes and therefore as complementary rather than competitive. Eastern Europe is regarded as offering new investment opportunities through which to pursue all-European strategies in anticipation of 1992. It is, above all, small and medium-sized West European firms that may now look to East European locations for expansion in lieu of more distant locations in Africa, Asia or Latin America.

118. It should also be noted that Eastern European direct investments in the developing countries have been growing in recent years. The total number of direct investments (companies established) by the four Eastern European countries under consideration stood at 225 by the end of 1990. Of these, 48 (21 per cent) were undertaken in the period 1987-1990.

119. The opening up of the Eastern European economies to foreign investment also has stimulated some investors from the developing countries. For example, of the 760 new joint ventures registered in the USSR in 1990, 65 (8.5 per cent) involved the capital participation of firms from the developing countries.

### 5. Impact of German unification on financial markets 6/

120. There are several methods of attempting to quantify capital requirements for eastern Germany over the medium term. A first approach is simply to sum up estimates recently published for various industries. Since the methodologies used in these industry-specific studies vary, and are often not even disclosed, the figures must be regarded as highly speculative, but they suggest a total "investment need" for eastern Germany of DM 1,500 billion to 2,000 billion over a 10-year period.

121. Another way of estimating the appropriate level of investment in eastern Germany is to estimate the amount required to match the western German level of annual gross investment per capita, which amounted to about DM 8,100 in 1990. On that basis, DM 130 billion should be invested annually in eastern Germany. It may be argued that in view of the need for infrastructure and modernization and to meet federal environmental standards, even greater amounts are needed. On the other hand, there is certainly a limit to the short-term capacity to absorb new capital. To put the amount into perspective, DM 130 billion is equal to 56 per cent of eastern Germany's GNP in 1990.

122. Finally, one may estimate the absolute increase in the capital stock necessary to support a certain GNP growth rate. If growth in eastern Germany were to begin in 1991 from a GNP of DM 200 billion and proceed at an average annual rate of growth of 10 per cent, GNP would increase by DM 272 billion over a nine-year period, to a level of DM 472 billion. If the average capital/output ratio of 3.3 for the economy of western Germany (including public infrastructure but excluding housing) is taken to represent the marginal capital/output ratio in eastern Germany, gross investment of about DM 110 billion per annum into plant, equipment and infrastructure would be required. To this figure, housing investment would have to be added.

123. There is some doubt as to whether a capital/output ratio of 3.3 is plausible at this stage of the growth process. In the short term, with a shortage of modern capital being a bottleneck in the process of development, even small capital injections may materially improve the growth potential; the marginal capital coefficient may therefore be lower than indicated. On the other hand, in the medium term the need to undertake major investments to improve the environment may raise the capital/output ratio above the level in western Germany.

124. Thus it appears that gross private and public investment of about DM 120 billion-130 billion per annum (DM 1,200 billion-1,300 billion over 10 years) may be "required". However, such sums would not need to be financed entirely by continued transfers from western Germany since increasing output and savings in eastern Germany would be expected to finance a growing proportion of annual investment. As regards the financing of the resources

actually transferred from western Germany to eastern Germany, a substantial portion will be raised by higher taxes. None the less, the impact of German unification can be expected to reduce the net supply of German domestic savings to the rest of the world; if this is $60 billion-80 billion per annum, it could mean an additional one half of a percentage point added to interest rates in world financial markets. If the external debt of developing countries subject to variable interest rates is $600 billion, this would mean an additional $3 billion per year in debt service payments, although induced changes in exchange rates may reduce the size of the dollar-denominated portion of the debt stock.

### C. The impact of reform in Eastern Europe and the USSR on selected developing countries

125. While it appears that the reforms in Eastern Europe and the USSR are unlikely to affect the developing countries as a group adversely in the short term and can be expected to benefit them in the long term, a number of countries have already begun to experience adverse effects ranging from moderate to severe. In this respect one may distinguish four groups of developing countries:

(a) Members of CMEA (Cuba, Mongolia and Viet Nam);

(b) Other major aid recipients with an observer status in the CMEA (Afghanistan, Ethiopia, the former Democratic Yemen, Mozambique, Angola and Nicaragua);

(c) Non-aligned countries with extensive trade and cooperation relations (Egypt, India, Syrian Arab Republic and Yugoslavia);

(d) Socialist developing countries (China, Cambodia, Lao People's Democratic Republic and Democratic People's Republic of Korea).

These are all countries that have had close trade relations with the Soviet Union and Eastern Europe and many of which receive significant amounts of foreign aid from the formerly centrally planned economies. Some of the countries likely to be most severely affected are Cuba, Ethiopia, Mongolia, Mozambique, Yugoslavia and Viet Nam.

126. In the short term, economic relations between these developing countries and Eastern Europe and the USSR are likely to be reduced to foreign trade. The number of joint venture projects in industry and infrastructure will virtually disappear, while loans and other forms of financial assistance will be greatly reduced.

127. According to recent estimates, Soviet grants and aid-in-kind to developing countries during the period 1981-1985 averaged $2.5 billion and in the five-year period 1986-1990 they averaged $2.7 billion. In 1991 it is estimated that Soviet aid will fall to $0.7 billion.

128. An issue of contention in relations between the USSR and a number of developing countries is the valuation of outstanding debt payment obligations. The situation is different from convertible currency debts within a West/South context. The disputes centre on the exchange rate at

which the debt should be repaid, and failure to come to an agreement interrupts the flow of trade. The matter has been complicated further by currency depreciation and the operation of multiple exchange rates.

### 1. Developing country members of CMEA

129. The three developing countries members of CMEA (Cuba, Mongolia and Viet Nam), together with Cambodia, absorbed about 70 per cent of total aid in the 1980s. Trade dependency was also extremely high; trade with the European CMEA countries accounted for between 75 and 95 per cent of their total trade.

130. Cuba is the largest economic partner of the USSR, but nearly all of its exports to the USSR consist of raw sugar. There is a strong likelihood that in order to preserve cooperation with Cuba, the Soviet Union will agree to a preferential price for sugar in 1991 - perhaps twice the world sugar price, but substantially lower than in 1990. Deliveries of fuel by the Soviet Union to Cuba are also to be greatly reduced, and it remains unclear whether Soviet enterprises will honor their contractual commitments to Cuba to sell other commodities readily marketable on world markets which have in the past accounted for 40 per cent of total Soviet exports to Cuba. Cuban industry has also been adversely affected by the insistence of Eastern European countries for payment in convertible currencies for industrial raw materials, spare parts and machinery.

131. These uncertainties regarding Cuba's trade with the USSR and other former CMEA countries have complicated efforts to resolve the problem of settling its arrears on service payments due to the USSR. Moreover, its efforts to diversify its trade continue to be hampered by the trade embargo imposed by the United States.

132. Economic ties with Mongolia and Viet Nam in the next two to three years can be expected to undergo dramatic changes both in structure and in volume. In connection with the transition beginning in 1991 to clearing payments on the basis of world prices and convertible currencies, the creditworthiness of these countries with regard to the USSR will be sharply reduced. Moreover, the annual volume of new credits and grant-aid are expected to contract by as much as 75 per cent. In the case of Viet Nam, a high percentage of contract labourers in Eastern Europe and the USSR are being repatriated, reducing remittances and credits earmarked for debt repayment. Adjusting to these changes will require a renegotiation and scaling down of their debt service obligations to the USSR, since they are to be settled in convertible currencies. Both countries can be expected to reorient much of their trade to Asian markets and suppliers.

### 2. Other major recipients of CMEA assistance

133. In addition to aid received from the USSR, countries such as Mozambique, Angola and Ethiopia received substantial technical assistance from the former German Democratic Republic. This mainly took the form of professional training in the Republic or on the job. The training programmes were highly sophisticated as compared to other CMEA countries, including the USSR. In the

German Democratic Republic, training was provided in educational institutions or in special schools of the Communist Party, the cooperatives, the trade unions and other mass organizations.

134. The prospects for the development assistance policy of unified Germany towards these countries are not explicit. However, some observations may be made:

(a) A socialist orientation is not likely to be a criterion for foreign assistance;

(b) Assistance in the form of trade subsidies cannot be envisaged in the future;

(c) A single German development policy might benefit from expanding its scope to include developing countries such as Mozambique or Angola which benefited from aid extended by the former German Democratic Republic, but had few relations with the Federal Republic.

### 3. Non-aligned developing countries

135. Eastern Europe and especially the Soviet Union have been a major market for manufactured products for a number of non-aligned developing countries, such as Egypt, India, the Syrian Arab Republic and Yugoslavia. A reduction of exports from these countries to Eastern Europe and the USSR and the replacement of clearing arrangements by payments in freely convertible currencies could have a serious negative impact on several industries in these developing countries.

136. The impacts on these countries are by no means uniform, however. In the cases of Egypt and the Syrian Arab Republic, much of their exports to the USSR were debt repayments in kind. The Syrian Arab Republic, in fact, has been recording large surpluses in its trade with the USSR, is not heavily dependent on the imports it receives, and could readily sell most of its exports destined to the USSR in international markets. In the case of Yugoslavia, difficulties in obtaining deliveries from the USSR of imports needed by the Yugoslav economy have led to the accumulation of a large credit in inconvertible roubles with the USSR. Consequently, Yugoslavia has instituted measures to reduce its exports to the Soviet Union with negative consequences for its export industries. In the case of India, Soviet exports of oil and military equipment have slowed, and the USSR is running heavy unplanned deficits with India. Whereas India's imports from Eastern Europe and the USSR are generally replaceable, its exports to them form a high proportion of its total exports for many products, including both primary commodities and manufactures. Its export industries have lost sales and face considerable uncertainty as a result of the disruption of its trade with Eastern Europe and especially with the USSR. Trade between India and the USSR is expected to continue but at lower levels than in the past, with little lasting damage to the Indian economy.

## 4. China

137. China's trade with the Soviet Union has been based on an exchange of light consumer goods from China for raw materials and heavy machinery from the USSR. Once the transition to convertible currency payments is completed, China is expected to purchase less heavy machinery and to seek other markets for its exports of light consumer goods. Problems with supplies from the Soviet Union resulted in a reduction of export to China during the first nine months of 1990 by about 6 per cent, with shortfalls concentrated in petroleum, rolled steel and timber. During the same period China's exports to the Soviet Union increased by 48 per cent.

## IV. INTERNATIONAL FINANCIAL COOPERATION FOR DEVELOPMENT

138. The economic performance of the developing countries as a group in the decade of the 1980s is acknowledged to have been insufficient. For many, a general reduction in the inflow of real resources coincided with low export revenues and a generally negative movement in the terms of trade. There was, moreover, a growing stock of external debt, the servicing of which was large in relation to gross domestic product. As a result, for much of the decade many developing countries were exporting more goods and non-factor services than they were receiving. This led to a sharp reduction in their capacity to finance domestic growth.

139. This was reflected in sluggish growth of gross domestic product (GDP), savings and investment. 1/ As to GDP growth, the average for all developing countries for the decade was 3.6 per cent per annum, while the average for 1989 was around 3 per cent. For sub-Saharan Africa the figures for 1989 and 1990 were 2.7 per cent and 2 per cent; those for Latin America and the Caribbean 1.1 per cent and -0.7 per cent. The exceptions were East and South Asia, which, despite declines in growth rates in 1989 and 1990, registered high growth rates throughout the 1980s. Because of the high rate of population growth for most of the developing countries, per capita GDP growth was less than 1 per cent.

140. The story of private consumption and investment was no different. Private consumption grew 2.2 per cent and 6.1 per cent per annum in sub-Saharan Africa, and Latin America and the Caribbean, respectively, between 1965 and 1980 and then dropped to an average rate of growth of 0.6 per cent and 1.2 per cent per annum over the period 1980-1988. East and South Asia, in contrast, recorded slightly higher growth rates in the latter period, as did also the low-income countries as a group.

141. Turning to gross domestic investment, an average growth rate of 7.9 per cent per annum for middle-income countries dropped to 1.2 per cent between 1980 and 1988, while the low-income countries as a group held steady at just under 5 per cent. For sub-Saharan Africa, the figures were 6.5 per cent, dropping to -11.8 per cent; and for Latin America and the Caribbean, 7.4 per cent, dropping to -3.3 per cent. Even South and East Asia saw a decline, from 8.5 per cent to 4.9 per cent.

142. Thus, although the overall growth performance of the developing countries was hardly insignificant, it was unevenly spread between the rapidly growing countries noted above and the weaker regions which suffered a decline. The causes of this decline were many and varied - from domestic policy errors compounding inherent structural limitations to a consistently hostile external economic environment. What is not in dispute is that, given their reduced capacity to generate from their own resources the levels of finance required to restore and maintain growth in their economies, most developing countries needed substantial amounts of external long-term finance. This would have enabled them to increase production, raise productivity, improve their capacity to rebuild infrastructure, and, generally, to reform their economies so as to make them more efficient and better able to sustain growth in the face of external economic crises. Unfortunately, an examination of the international movements of long-term finance reveals the failure of developing

countries to receive such support. The overall picture was one of stagnation in real aggregate net resource flows and, more significantly, of negative aggregate net transfers to developing countries as a group for much of the decade (table 2).

143. This failure of external development finance was both a cause and an effect of the general decline in the economic performance of the developing countries of Africa, Latin America and the Caribbean in the 1980s. While the lack of long-term finance to power their growth contributed to their failure to register or maintain appropriate growth rates, the decline in the performance of their economies also rendered them progressively less attractive, particularly to private external capital, which therefore dried up. This, of course, exacerbated the decline. This two-stage effect is reflected in the changes in the composition of aggregate resource flows to the developing countries, with the ratio of annual average official to private development finance (net private loans and foreign direct investment) changing from 41:59 in 1980-1984, to 61:39 in 1985-1989, in a situation where there was a generally decreasing absolute flow of real resources to all developing countries (table 2).

144. At the dawn of the 1990s, therefore, many developing countries, with notable exceptions, were in dire economic and financial straits. It was clear that without a substantial national and international effort to effect radical change, the new decade promised to be no better - indeed, threatened to be worse - than the old. A promising factor was the emerging consensus and commitment in many of those countries to reform and restructure their domestic policies. This commitment at the national level underscored the need for a corresponding international commitment. It was against this background that the International Development Strategy for the Fourth United Nations Development Decade was adopted by the General Assembly, to take effect on 1 January 1991. In its own words:

> "The principal aim of the [Strategy] is to ensure that the 1990s are a decade of accelerated development in the developing countries and strengthened international cooperation." 8/

Among the many factors identified in the Strategy as accounting for the parlous condition of many developing countries was the inadequacy of external resources to help sustain the development process. It also noted the overall decline in primary commodity prices, the general reduction in the aid budgets of many donor countries, and the heavy debt burden weighing on developing countries. Recognizing that restoration of the tempo of development in the developing world was "virtually unimaginable" under such conditions, the Strategy stated:

> "The new consensus on the need for a reactivation of development and on the priorities of development policies calls for a new commitment on the part of the international community to augment the flow of development finance to the levels needed to attain these agreed goals." 9/

Table 2. Net transfer of financial resources to capital-importing developing countries, a/ 1980-1990

(Billions of dollars)

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 b/ |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Transfer through direct investment | | | | | | | | | | | |
| Net investment flow | 5.8 | 9.7 | 7.1 | 6.2 | 6.2 | 7.4 | 5.9 | 9.3 | 14.5 | 15.9 | 16.5 |
| Net dividends and other income | -10.7 | -10.2 | -9.8 | -9.3 | -8.6 | -8.0 | -7.1 | -8.1 | -8.6 | -11.1 | -12.1 |
| Net transfer | -4.9 | -0.5 | -2.7 | -3.1 | -2.4 | -0.6 | -1.2 | 1.3 | 5.9 | 4.8 | 4.5 |
| Transfer through long-term foreign private borrowing | | | | | | | | | | | |
| Net credit flow | 35.4 | 48.3 | 41.0 | 26.8 | 18.5 | 12.5 | 7.6 | 2.1 | 7.6 | 3.6 | 2.4 |
| Interest paid | -24.1 | -31.2 | -37.2 | -35.5 | -40.3 | -39.2 | -34.8 | -33.8 | -39.4 | -32.6 | -32.2 |
| Net transfer | 11.3 | 17.2 | 3.8 | -8.7 | -21.8 | -26.7 | -27.2 | -31.7 | -31.8 | -29.1 | -29.8 |
| Transfer through short-term borrowing and domestic outflows c/ | | | | | | | | | | | |
| Net transfer | 5.0 | -12.5 | -27.5 | -18.9 | -13.7 | -9.3 | 0.5 | -2.3 | -10.4 | -3.4 | 1.2 |
| Transfer through private grants (net) | 1.7 | 1.8 | 1.7 | 2.1 | 2.6 | 2.9 | 3.8 | 4.1 | 4.8 | 3.4 | 3.3 |
| Transfer through official flows | | | | | | | | | | | |
| Official transfers (grants) | 11.2 | 11.9 | 9.2 | 10.1 | 10.8 | 11.8 | 11.2 | 12.6 | 12.8 | 13.4 | 17.8 |
| Net official credits | 23.4 | 28.6 | 31.3 | 27.6 | 25.5 | 16.9 | 16.6 | 13.7 | 15.9 | 16.6 | 27.4 |
| Interest paid | -5.8 | -6.7 | -8.2 | -9.6 | -11.1 | -12.7 | -15.6 | -16.8 | -18.3 | -18.3 | -22.6 |
| Net transfer | 28.8 | 33.7 | 32.3 | 28.2 | 25.2 | 15.9 | 12.2 | 9.5 | 10.5 | 11.7 | 22.6 |
| Total net transfer (financial basis) | 41.9 | 39.7 | 7.6 | -0.6 | -10.2 | -17.8 | -11.9 | -19.1 | -21.0 | -12.6 | 1.7 |
| Use of official reserves d/ | -14.7 | 3.0 | 19.2 | -6.3 | -18.8 | 1.2 | 8.3 | -14.1 | -10.6 | -14.6 | -23.4 |
| Total net transfer (expenditure basis) | 27.2 | 42.7 | 26.8 | -6.9 | -29.0 | -16.6 | -3.6 | -33.2 | -31.6 | -27.1 | -21.7 |

Source: World Economic Survey, 1991 (United Nations publication, forthcoming).

a/ Sample of 93 countries.

b/ Preliminary estimate, rounded to the nearest half-billion dollars.

c/ Calculated as a residual (including short-term trade financing, normal and unusual outflows ("capital flight")), arrears on interest due, and other flows captured in balance-of-payments data as errors and omissions and presumed to be financial flows.

d/ Additions to reserves shown as negative numbers.

145. This call to the international community to increase the flow of development finance has engaged the attention of the Committee on Development Planning. This chapter will examine the broad issue of international financial cooperation for development, taking into account the prospects for its improvement in the coming decade, and will suggest possible measures for their improvement.

146. After a brief reference to major political events likely to influence the context of international economic relations, attention will be turned to an examination of factors affecting the availability and use of financial resources in international development.

## A. Major political developments affecting the context for resource mobilization and use in support of the International Development Strategy

### 1. Easing of East/West tensions

147. The decade of the 1980s ended with a series of dramatic changes in East/West relationships, bringing the Cold War to a decisive end. Featuring prominently among these changes were the Helsinki Accord; arms control agreements between the United States and the USSR; the spectacular political changes in Central and Eastern Europe and in the Soviet Union itself; and finally the unification of Germany and the collapse of the Warsaw Pact. The decade of the 1990s can therefore be legitimately said to have begun with an "outbreak of peace" - at least in relations between the super-Powers.

148. The most obvious effect of the end of the Cold War is the lowering of tension between the major power blocs and a further retreat of the threat of global war. This offers an unprecedented opportunity for the abatement of the arms race between the super-Powers, and a consequent moderation in their expenditures on arms and the armed forces. It would be naïve not to recognize that existing commitments to arms production, the existence of powerful establishments with vested interests in their production and use, and enduring traditions of militarism will ensure there is a lag between the reduction in the need for massive arms industries and large armies and an actual reduction in armaments and armed forces. The outbreak and conduct of the Gulf War suggest that military power has not ceased to play a role in international affairs, while the persistence of numerous wars in the third world are indications of the need for further caution in our expectations.

149. None the less, the realization of even a modest "peace dividend" could result in the generation of increased surpluses both for domestic investment and consumption and for increased development finance. It must be emphasized that there is nothing automatic about such a reallocation of resources. Indeed, it is not inconceivable that with the ending of the Cold War, development assistance may have a lower priority in one or two of the leading donor countries.

150. Secondly, the reduction of super-Power rivalry in the third world should not only reduce the frequency of war but also improve the prospects of coordinated super-Power action to end or prevent wars. For instance, agreements to suspend shipments of arms to the parties of an armed conflict

could be more readily reached. Any reduction, however small, in the wasteful purchase of modern weapons systems and the maintenance of large standing armies will itself constitute a considerable "peace dividend" for these desperately poor countries.

151. Thirdly, the ending of the Cold War can be expected to reduce the importance of strategic geopolitical considerations relative to the need to foster development in the selection of the form, purpose and beneficiaries of official development assistance. One of the saddest features of the Cold War era was the large proportion of assistance devoted to military aid and support for strategic allies. For example, 41 per cent of external assistance in 1988 was directed to middle- and high-income countries, largely for geopolitical reasons. Again, it has been estimated that a 10-per-cent reduction in military spending by NATO would make it possible to double the amount available for aid to the developing countries. In the past, ODA was not always targeted at the neediest countries nor properly focused on the priority areas of development, especially by the major Powers.

152. It would be unrealistic, however, to expect any marked or irreversible change in the habits and attitudes developed over the past 40 years. Recently Egypt's $7 billion debt to its Arab coalition partners in the Gulf War and its $7 billion military debt to the United States were forgiven. These are pointed reminders of the continued relevance of non-economic criteria. Similarly, the treatment of the Polish debt by the OECD countries and the prompt establishment of the European Bank for Reconstruction and Development to support reforms in Eastern Europe and the USSR reflect priorities derived from geopolitical considerations. At the same time they can be seen as examples of how industrial countries may redirect aid from previous military confrontation to new developmental efforts in Eastern Europe and the developing countries.

153. While there can thus be no guarantee that strategic and geopolitical considerations will cease to dominate the allocation of ODA, an opportunity does now exist for mobilizing support on a broad front in favour of non-military, non-strategic factors as determinants of foreign financial flows, especially ODA.

### 2. Concern for the environment

154. Among the positive trends on the international political scene is the generalized concern for the restoration and maintenance of an adequately supportive physical environment for all mankind. There is increasing recognition that uncontrolled industrial development and resource wastage in the industrialized countries, and poverty, especially, but not exclusively, in the developing countries, pose a threat to the environmental health of all mankind. This subject will be treated separately at the twenty-eighth session of the Committee. For present purposes, however, one need only observe that one of the outcomes of this increasing awareness and activism has been the creation in some instances of powerful environmental interest groups. These interest groups could perhaps be organized to exert pressure on the industrialized countries for adequate development assistance to developing countries, if only to avert the kinds of poverty and pollution that threaten international efforts to restore and maintain a healthy environment for the

whole world. As will be seen in what follows, a considerable orientation and promotional effort will be required in the industrialized countries to secure adequate budgetary allocations for development assistance in support of the objectives of the International Development Strategy. It is possible to imagine that environmentalists, properly oriented and organized, could be drawn into an alliance of pressure groups behind such promotional campaigns.

### 3. Reform in the political and economic systems of Eastern Europe and the USSR

155. As discussed in chapter III, the political and economic changes taking place in Eastern Europe and the USSR are not likely to have a large bearing on the availability and use of international financial resources for developing countries - e.g., in support of the implementation of structural reforms. However, the experience of the countries engaged in the reform process may yield important lessons for developing countries. And in the long run, economic growth in Eastern Europe and the USSR could improve opportunities for trade and encourage them to become aid donors and therefore net contributors to the international development effort on behalf of the developing countries.

### 4. Democracy and development

156. The issue of available financial flows for developing countries has become particularly urgent because of the trend towards democratization in parts of the developing world. The opening of political systems to wider participation by all groups can serve both to enhance the efficiency of resource use and to create greater domestic and international support for development policies. However, participation implies that more time for decision-making may be required than under an authoritarian regime, a factor which should not be ignored in setting targets in the implementation of reform programmes.

157. It is difficult for a democratic Government to accommodate social demands without economic expansion. Growth creates the additional resources needed to meet the expectations of all social groups. Failure to address these expectations weakens public confidence in both democratic institutions, especially when they are new - and market-oriented - economic reforms. If political reforms fail, economic and social transformation will probably fail as well. The consolidation of democratic transitions therefore will be an important factor in the evolution of a more open, flexible and dynamic world economy. Certainly, the international community has a stake in such an outcome and must be prepared to step up financial assistance to developing countries attempting to reform their political institutions.

### 5. National impediments to international migration

158. A world economy without national boundaries would witness a substantially altered geographical distribution of the world population: if they were free to move, people would migrate in large numbers from the developing countries to the industrial countries. There would also be migrations between developing countries as well as migrations between developed ones. This

process would result in a greater equalization of economic opportunities for labour. The distribution of world income would be altered significantly since relative real wages would decrease for those formerly residing in high-wage countries and would increase for those formerly residing in the developing countries. World welfare would increase as the riches of the world economy became better distributed among the total population of the world.

159. National sentiments are, however, stronger than ever in the industrial countries against adopting a policy of free migration flows from the developing countries. A case can therefore be made for compensatory policies to correct for policy discrimination against the free international movement of labour. This might, for example, be used as an argument for larger flows of foreign aid. Social and political factors are raised by the industrialized countries as justifications for their discriminatory and world welfare-depressing anti-migration policies. Yet the same or similar social and political factors are frequently regarded as unacceptable when the discussion centres on the reluctance of developing countries to accept the economic rationale of the free movement of private capital.

## B. Major factors affecting the availability and use of resources for financing the International Development Strategy

160. The International Development Strategy requires, on the one hand, the generation and mobilization of savings in the industrialized countries, some of which is made available for use in international development, and, on the other, the creation of conditions in the developing countries that attract external resources and ensure their productive use. Thus the realization of the new opportunities created by the political developments outlined above will depend crucially - though not exclusively - on policies adopted and applied in both the industrialized and the developing countries.

### 1. Conditions in the industrialized countries

161. Although the decade of the 1980s witnessed strong growth of national income in the industrialized countries, this was largely offset by even greater consumption in some of those countries. The result was a reduction rather than an increase in the amount of available savings. At the beginning of the 1990s a change in this pattern is emerging, with a reduction in growth both of national income and of consumption in most industrialized countries. The longer-term effects of this trend will depend on the relative movements in the two magnitudes.

162. Persistent structural fiscal deficits, which represent public decisions to spend systematically more than their revenues, result in the absorption of private-sector savings in financing public expenditures, which reduce the resources available for private investment in both the industrialized and the developing countries. Unfortunately these deficits are generally on the increase at the beginning of the 1990s. The federal budget deficit in the United States is expected to be about 3.5 per cent of GNP in 1991, while the fiscal balance of general government in Germany has moved from rough balance in 1989 to a projected deficit of more than 4 per cent of GNP in 1991.

Moreover, fiscal deficits can be expected to rise in Japan as foreign pressure pushes her to expand infrastructural and other public spending.

163. Even where domestic surpluses are generated, their contribution to international development turns on the uses to which they are put. They could, for instance, be invested within the domestic economy for social services, rehabilitation of infrastructure or in directly productive activity. Where domestic savings exceed domestic investment, the excess flows to foreign markets, showing up as a current account deficit. Conversely, where domestic investments exceed domestic savings, capital is imported, and this shows up as a current account surplus. In the 1980s some major industrialized countries ran considerable current account deficits, absorbing savings generated elsewhere.

164. The impact of these deficits in the industrialized countries on the international flow of resources can be summarized as follows:

(a) They crowd out private savings, thereby reducing the volume of resources available as international flows, especially in the form of foreign direct investment and commercial bank lending;

(b) They increase the cost of capital, leading to rises in interest rates and therefore increases in the cost of capital flowing to developing countries;

(c) They generate strong domestic pressure for reductions in public spending, from which ODA is not immune;

(d) Within the industrialized countries themselves, they lead either to a slowdown of growth, as a result of interest rate increases, or to inflation. In the former case, the demand for imports from developing countries drops off, while in the latter, the cost of exports to developing countries goes up.

165. It is thus clear that management of fiscal policy in the industrialized countries has a direct and profound effect on the development prospects of developing countries. Since the object is not to discourage domestic investment in the industrialized countries, stress must be laid on the need to adopt fiscal and monetary policies that encourage the generation of more domestic savings and that therefore require less borrowing from international capital markets.

166. If present trends continue, the levels of official and private resource flows to developing countries in the 1990s will be affected by:

(a) Reduced availability of public savings in the industrialized countries as a result of fiscal and monetary policy;

(b) Competition from investment opportunities in the industrialized countries themselves, the countries of Eastern Europe and the USSR, and the newly industrialized countries of South and East Asia.

167. In order to alter these trends and thereby improve the chances of success of the International Development Strategy, it will be necessary for the industrialized countries to adopt domestic policies that lead to the reduction or removal of structural fiscal deficits. The industrialized countries will also have to adopt and promote policies that favour public and private resource flows to developing countries. It is in this latter connection that a coalition of interest groups within the industrialized countries, pushing for international development cooperation, becomes essential if the International Development Strategy is to have any chance of achieving its objectives.

168. The difficulties of mobilizing support should not be underestimated. The period of decolonization and the emergence as independent nations of many developing economies occurred several decades ago. Public support in the industrialized countries for foreign aid programmes dates from that time. Most of those alive today in the industrialized countries, however, were born after those epoch-making events occurred, and the empathy of the younger generation with the developing countries is therefore not as great. Moreover, within the industrialized countries there has been a change in ideology, a movement in favour of self-reliance and against the welfare state. This shift in public opinion as regards domestic policy may well have implications for foreign economic policy. Finally, the public in many industrial countries now perceive some of the developing countries, particularly the newly industrializing countries, as major competitors, and this, too, affects attitudes towards foreign aid in general.

## 2. Conditions in developing countries

169. The unacceptably poor performance of the economies of many developing countries in the 1980s had internal as well as external causes.

170. In response to these conditions, many developing countries are engaged in serious domestic economic policy reforms. The reforms will be credible and successful only if they are internally consistent and clearly spelled out. They must also be politically viable. International institutions have to work with national Governments both to improve the capacity of the public sector to implement reform programmes and to develop supportive networks of domestic groups and institutions to legitimize the process of reform.

171. In the absence of foreign capital transfers to underpin development, domestic saving must necessarily increase in order to finance any increase in investment. The objective, however, is to create an attractive economic environment which encourages a high level of investment demand and which then, in turn, encourages buoyant domestic savings, discourages domestic savings from moving abroad, and also attracts foreign capital for productive investment. None of this is likely to occur unless inflation can be controlled and the productivity of investment increased. This reality has led to the conclusion that private consumption has to decrease and that structural budget deficits have to be drastically reduced. Thus stabilization programmes have included all or a combination of the following measures:

(a) A sizeable reduction of public deficits through expenditure cuts, abolition of subsidies and tax revenue increases;

(b) Reduction of excess liquidity, usually through the pursuit of restrictive credit policies and increases in real interest rates;

(c) Pursuit of more realistic exchange rate policies.

172. Unfortunately, however, the policy package is overly simple: internal and external imbalances in developing countries are often caused not by "overconsumption" but by misdirected consumption (e.g., military spending), "underproduction" and by "inefficient production". Thus, domestic saving cannot be increased significantly at the expense of the overall level of consumption, which is low by international standards, but can be generated only through the reallocation of consumption and the expansion of incomes - i.e., through expansion of production and the promotion of efficiency and competitiveness. Without some sense of priorities and some degree of growth, most Governments end up reducing public investment projects, especially in economic and social infrastructure. As a result, severe bottlenecks tend to appear in the functioning of private markets due to the lack of "social" capital, a much needed complement to private capital.

173. It should be clear from the above that what is primarily required is not a decline in total expenditure but a shift in its composition. More specifically, domestic saving in relation to national income must increase substantially. Appropriate policies can encourage such a shift, but the shift that is needed is of a magnitude that requires fundamental changes in the political underpinnings of society. What is actually required is a new "development ethic" that would bind together social groups in a winning grand coalition.

174. A first such step that needs to be taken is for the Government to take decisive measures to streamline and modernize the public sector and restore its credibility in the eyes of the people. There are certain programmes that should be protected as much as possible from the annual ups and downs of the budget process. Three such programmes are singled out:

(a) Public investment in physical capital and in human resources must be maintained at a pace consistent with a satisfactory path of development;

(b) Programmes relating to education and health should not bear the brunt of adjustment. They provide services that are critical to human resource development and the longer-term prospects of political democracy;

(c) Programmes designed to satisfy the basic needs of the poorer segments of the population are essential and should not be cut back.

Unfortunately, these programmes often have been the main victims of stabilization plans, partly because they are supported primarily by relatively weak political constituencies. If multilateral financial institutions - especially the World Bank and the IMF - can lend their support for these expenditure programmes, there is a good chance that adjustment programmes will gain wider support and may become more viable - at least in political terms.

175. Policies for a smooth and sustainable adjustment have to include microeconomic and structural reforms as well as macroeconomic stabilization policies. The one-sided application of demand restrictive policies is not

effective if industrial and bureaucratic inefficiencies are not addressed through microeconomic, supply-oriented policies.

176. Structural reforms include institutional policy reforms which emphasize efficiency in the economy, and include such matters as trade liberalization, fiscal and financial market reforms, reduction in exchange and price controls, privatization, and liberalization of conditions for investment for both domestic and foreign investors. Of special concern are the modernization of enterprises, the reorganization of the public sector, and the retraining and re-employment of workers.

177. An important component of such policies is the promotion of entrepreneurship through learning by doing. Risk-taking, the gathering and use of market information, organizational techniques for production and marketing, the efficient use of resources, the capacity to organize teams for particular tasks and finally the efficient execution and evaluation of programmes need to be learned. This requires time, assistance and concerted effort.

Box 1

The public sector in developing countries

It has been argued, often quite convincingly, that the public sector is an inferior manager compared to the private sector. Where this is the case, privatization of State enterprises would enhance competition and efficiency. While no easy generalizations can be made, there are a few points of a general nature that can be raised. If efficiency is to be the key criterion for deciding whether an enterprise under public control should be privatized or not, it may be useful to consider four types of public enterprises that can be found in developing countries: relatively small firms, coexisting competitively with private firms; natural monopolies; firms producing services to the public which are generally considered social goods; and large enterprises that hold an oligopolistic position in key sectors of the economy.

There seems to be a general agreement that the State should move out of small firm activities. Indeed a strong case can be made that public wealth can be used more profitably - from a development point of view - elsewhere.

In the second category, the privatization of monopolies rests on the assumption that a private monopoly would be more efficient than a public monopoly. If this is the case,* however, the potential costs that the Government must incur in order to set up regulatory machinery may offset efficiency gains. On the other hand, if foreign competition for private monopolies can be introduced, governmental regulation may be unnecessary.

In the third category, State enterprises provide services to the public at prices considerably below cost (for example, urban transportation). If an enterprise of this type is privatized, the main issue will revolve around the appropriate size of the subsidy to be paid by the Government.

Lastly, there are cases of relatively large firms which operate in dynamic sectors of the economy. In some cases, these firms (e.g., telecommunication companies) are focal points in which research and technology may be promoted to drive industrialization and technology processes. To the extent that all Governments subsidize such industries, developing countries may wish to do so as well, although this competitive subsidization, unless disciplined by global rules in the world trading system, can lead to serious economic and social losses.

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* It should be noted that many of these monopolies were in the past in private hands and were nationalized because they were considered inefficient and insensitive to the needs of the consumers.

## 3. International support for domestic reforms

### (a) The design of reform programmes

178. Virtually all reform programmes rely upon substantial increases in export revenues as well as other external financial inflows. There is little doubt that the success of reforms cannot be ensured without substantial flows of foreign exchange in the form of short- to medium-term loans and direct investment and increased and steady export revenues. Without such resource inflows the social and political costs of economic adjustment become unbearable, rendering reform programmes ultimately unsustainable. Again, the availability of ready export markets and remunerative prices for the products exported by developing countries are essential for growth of the export sectors of those economies, and this in turn is a condition for the success of their reform programmes. It is in this sense that the prospects of economic regeneration and sustained development in developing countries can be said to depend on international financial cooperation.

179. To the extent that current economic reform programmes in the developing countries succeed, their economies are expected to become more productive and therefore more attractive to foreign private capital. In addition, through the improvement in the management of their economies and in their absorptive capacity generally, external inflows, including ODA, are more likely than before to be efficiently and productively utilized. Put another way, international financial support for the reforms under way in developing countries - provided it is timely and in adequate amounts - not only increases the chances of success of those reforms but that very success renders their economies more attractive to external inflows and therefore makes it easier for them to wean themselves from external assistance.

180. Serious reservations have been expressed about the appropriateness and the prospects of many current economic reform programmes in the developing countries. These reservations relate primarily to inconsistencies in the reform packages, their inadequate recognition of the political and social impediments to implementation and to the human welfare costs. Concern is also expressed that the preconditions outlined above for the success of the reforms are unlikely to be met, given the current international economic and political order. What are the chances of substantial improvements in access for the products of the reforming economies, especially manufactures, to the markets of the developed countries? The record of protectionism in recent years, the increasing resort to trading blocs and the fate of the Uruguay Round of GATT negotiations give cause for concern.

181. Again, can reforming economies count on sufficiently large and sustained inflows of financial and other resources to ensure adequate support for their programmes and ease the social and political hardships that inevitably accompany economic stabilization and adjustment programmes? Finally, there is a strong feeling that the social and political tensions generated by the reforms are likely to derail the process in most developing countries before the benefits of reform are achieved, unless specific measures are taken.

182. While it is premature to conclude that the reform programmes will not succeed, the critical point is to appreciate the link between the reform effort in individual developing countries and necessary changes in the international economic environment.

183. However successful is the generation of surpluses in the developed countries and however strenuous is the reform effort in the poorer developing countries, the prospects for growth and development in the latter countries in the 1990s will depend on the conditions for the movement of goods, services and capital in international commerce. If the 1990s are to take a different path from the 1980s and show real growth in the poorer parts of the world, a number of fundamental international changes are absolutely vital.

(b) International trade

184. Efforts to increase financial flows to developing countries can come to naught unless the international trading system facilitates the transfer of real goods and services. The impact of grants and other financial assistance can be dissipated by trade arrangements that raise prices, limit supplies or otherwise discriminate against efficient producers. Most importantly, there is little likelihood of once again attracting substantial nonconcessional finance to developing countries (bank lending and foreign direct investment) without the prospect of expanding exports on a predictable basis to industrial countries.

185. An important feature of almost all the economic reform programmes in the developing countries is their emphasis on export-led growth. Resources have been diverted to expanding production of traditional exports and developing new export products. Moreover, there is great interest in moving away from primary commodity production towards a greater measure of processing for export. Without a vigorous expansion in export growth, the reform programmes stand little chance of success. Expansion of developing country exports in international trade therefore assumes particular importance for reforming developing countries.

186. The erosion of multilateralism in world trade by the resort to protectionism, voluntary export restraints, bilateralism and regional trading blocs thus pose major problems for the success of the export-led economic development strategies that characterize most of the current economic reform programmes in the developing countries.

187. Among the most significant developments are the single-European market planned for 1992, the tariff reductions being negotiated for the reforming countries of Eastern Europe and the USSR and the transformation of the centrally planned economies. These matters and their implications have been covered in greater detail in the previous chapter. What needs emphasis is the very real link between a successful outcome of the Uruguay Round of GATT negotiations and the prospects for the export-led strategies of the reforming developing countries.

188. Regional trade arrangements, extensively covered in the report of the Committee for Development Planning of 1990, 10/ are not likely to be as beneficial to developing countries as improved access to global markets. One effect of regional trade areas will be to concentrate the impact of labour-intensive exports from developing countries on a few industrial country markets and therefore exacerbate pressures for protectionism. Moreover, these areas will also limit the opportunities to diversify their export markets and therefore lead them to depend more heavily on previous colonial Powers. This

would reverse a healthy trend since decolonization towards greater diversity in developing country relations with the developed market economies.

(c) International financial flows

189. Net official development finance (ODF), which includes ODA and the less concessional multilateral flows and certain bilateral flows, reached an estimated $69 billion in 1989, according to estimates published by the Development Assistance Committee.

190. Table 3 provides an overview of ODF over the past decade. It has grown in current dollars from $45 billion to $69 billion between 1981 and 1989. It now accounts for 63 per cent of the total net resource flows to developing countries, up from 33 per cent at the beginning of the 1980s. The principal reason for the pronounced increase in the proportion accounted for by official finance is the evaporation of private bank lending to developing countries, which fell from 38 per cent to 7 per cent of net resource flows to developing countries over the 1980s.

191. ODA is the largest part of official flows to developing countries, amounting to an estimated $53.1 billion in 1989, up from $36.8 billion in 1981, and accounting for 48 per cent of total official and private flows, up from 27 per cent in 1981. ODA in 1989 accounted for 76 per cent of all official flows to developing countries. The evolution of ODA will be critically important in determining the overall level of official resources available to developing countries in the medium term.

192. Other official development finance, made up of less concessional multilateral transfers and certain bilateral loans and guarantees, also demonstrated growth in nominal dollar terms during the 1980s, rising from $8.7 billion to $15.9 billion over 1981-1989. In real terms this represents a 20-per-cent increase over the decade. The robust increase in these flows, mostly to middle-income countries in Latin America and South-East Asia, is a result of strong growth in bilateral transfers, particularly from Japan and the former Federal Republic of Germany, and have more than offset a recent decline in multilateral disbursements.

193. Being more market based than the other official flows, export credits have been quite sensitive to official perceptions of credit-worthiness among developing countries. They have fallen from 13 per cent of total flows and 38 per cent of official flows in 1981 to 1 per cent of overall flows and 1.7 per cent of official flows in 1989 and have tended to dry up altogether for the poorer and middle-income and debt-distressed developing countries.

194. There are two trends especially worthy of note with respect to official development finance. While ODA has been growing in nominal dollar terms in the 1980s, it has been stagnant in real terms (see table 3). Such growth as has occurred has come from members of the Development Assistance Committee (DAC). Whereas non-DAC aid - and in particular aid from Arab donors - had accounted for 21 per cent of world ODA in 1981, by 1989 this share had fallen to 3.5 per cent. Given the outlook for the Middle East, ODA will become more dependent upon DAC members in the next five years.

Table 3. Total net flows of official development finance to developing countries a/

| | Amount b/ | | | | | | | | | Percentage | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1981 | 1985 | 1989 |
| Official development finance (ODF) | 45.5 | 44.2 | 42.4 | 47.7 | 48.9 | 56.3 | 61.6 | 66.0 | 69.0 | 33.1 | 58.0 | 62.5 |
| Official development assistance (ODA) | 36.8 | 33.9 | 33.9 | 35.0 | 37.3 | 44.5 | 48.3 | 51.6 | 53.1 | 26.8 | 44.2 | 48.1 |
| Bilateral disbursements | 28.9 | 26.3 | 26.3 | 27.2 | 28.8 | 34.9 | 38.2 | 40.3 | 40.5 | 21.0 | 34.2 | 36.7 |
| Multilateral disbursements | 7.9 | 7.6 | 7.6 | 7.8 | 8.5 | 9.6 | 10.1 | 11.3 | 12.6 | 5.7 | 10.1 | 11.4 |
| Other ODF | 8.7 | 10.3 | 8.5 | 12.7 | 11.6 | 11.8 | 13.3 | 14.4 | 15.9 | 6.3 | 13.8 | 14.4 |
| Bilateral disbursements | 3.0 | 3.7 | 1.3 | 4.5 | 3.7 | 4.0 | 6.6 | 7.9 | 9.0 | 2.2 | 4.4 | 8.2 |
| Multilateral disbursements | 5.7 | 6.6 | 7.2 | 8.2 | 7.9 | 7.8 | 6.7 | 6.5 | 6.9 | 4.1 | 9.4 | 6.2 |
| Total export credits | 17.6 | 13.7 | 4.6 | 6.2 | 4.0 | -0.7 | -2.6 | -0.5 | 1.2 | 12.8 | 4.7 | 1.1 |
| DAC c/ countries | 16.2 | 12.7 | 3.9 | 5.2 | 3.4 | -0.9 | -2.9 | -0.9 | 1.0 | 11.8 | 4.0 | 0.9 |
| Short-term | 2.9 | 3.0 | -3.5 | 0.3 | 3.2 | 3.0 | 4.1 | 2.0 | 1.0 | 2.1 | 3.8 | 0.9 |
| Other countries | 1.4 | 1.0 | 0.7 | 1.0 | 0.6 | 0.2 | 0.3 | 0.4 | 0.2 | 1.0 | 0.7 | 0.2 |
| International bank lending c/ | 52.3 | 37.9 | 35.0 | 17.2 | 15.2 | 7.0 | 7.0 | 5.8 | 8.0 | 38.1 | 18.0 | 7.2 |
| ODA at 1988 prices and exchange rates | | | | | | | | | | | | |
| Total from all sources | 54.1 | 51.0 | 51.1 | 53.8 | 56.8 | 54.9 | 51.8 | 51.6 | 53.6 | - | - | - |
| Total DAC | 37.6 | 41.8 | 41.6 | 44.2 | 44.8 | 45.3 | 44.6 | 48.1 | 47.4 | - | - | - |

| | 1970-1971 | 1975-1976 | 1980-1981 | 1988-1989 |
|---|---|---|---|---|
| ODA as percentage of GNP of DAC member countries | 0.34 | 0.35 | 0.34 | 0.35 |
| Arab donors' ODA as percentage of total ODA | 4.7 | 24.3 | 23.0 | 3.5 |

Source: OECD, Development Corporation Report, 1990.

a/ From all sources, except Taiwan, Province of China.

b/ Billions of dollars.

c/ Development Assistance Committee, OECD.

195. Within the DAC members, the ODA/GNP ratio has remained stagnant over the past five years, fluctuating between 0.36 per cent and 0.33 per cent of GNP. This ODA/GNP ratio has not increased despite seven years of uninterrupted growth among OECD member countries. This stagnant relative aid effort during a growth phase may well presage even more pressure on aid budgets and the ODA/GNP ratio among DAC members if the current recession is prolonged. As noted above, a number of political changes in donor countries may result in declining public support for foreign aid. The prospects for official development assistance are thus uncertain. Moreover, there is certain to be a fall in aid from the USSR and Eastern and Central Europe, as discussed in the previous chapter.

(d) Implications

196. The ideal situation would be for developing countries to be in a position to attract and service private external financial resources to supplement domestic savings. This happened in recent times in the case of the successful countries of East Asia, which have managed respectable growth rates throughout the 1980s.

197. For the weaker developing countries, especially in sub-Saharan Africa and the Caribbean, however, the story has been quite different. They are unable to attract the private inflows that would be needed to put them on a positive growth path, nor can they service such inflows. For this reason they will continue to depend on bilateral ODA and multilateral concessional flows.

198. The objective should be to use ODA to help them generate local savings and improve import capacity as a basis for resuming economic growth. The resumption of growth should generate local savings, improve prospects for attracting and servicing private inflows, and thereby ultimately reduce dependence on ODA.

199. In the short term, however, the prospects of such countries are for increased dependence on ODA. This is likely to increase their inclination to accept the policy advice offered by the donors and multilateral financial institutions. That inclination is encouraging in so far as it reflects a recognition that structural reform is a necessary condition for sustained growth and development. At the same time, however, it implies that responsibility for policy decisions in developing countries is shifting towards agencies involved in official development finance.

200. The multilateral financial institutions, particularly the World Bank and the IMF, have been subject to increasing criticism not only from economists in both the developed and developing countries but also from non-governmental organizations and other international agencies concerned with social development issues. The criticism deals mainly with the negative impact of structural adjustment programmes on the most vulnerable sectors of the developing countries and on the long-term development prospects of the countries themselves.

201. Although it is recognized that the benefits of structural reforms materialize in the medium and long term, there are immediate costs, and the need for additional resources to mitigate those costs is very often ignored, thus exposing the country unnecessarily to increased social and political tensions.

202. These problems must be addressed if a loss of confidence in the efficacy of real structural reforms is to be avoided. Also at stake is the credibility of the developing country Governments and the official development agencies themselves.

203. A closely related issue is the poor quality of existing ODA. Widespread tying of aid packages reduces the net real value of the resources transferred. At the same time, aid encourages centralized economic decision-making, directly or indirectly, and can work against openness and accountability. Tied aid in the productive sector can also work against competitiveness. Recent experiences with more "participatory" projects, involving human resource development and institution-building at the community level, have been more positive. These approaches can reinforce political and economic reforms at the national level. It should be recognized, however, that mobilizing people's creative and productive energy will result in political challenges and conflict rather than growth unless public expectations continue to be met. This depends not only on national policies but on a more supportive international economic environment.

204. More attention to the quality of aid would also go some way towards alleviating aid fatigue among donors. The more efficient use of aid, as with any resource, might actually enhance the environment for further investment in that resource - in this case, increases in the actual volume of aid.

205. In the first half of 1990, private banks in OECD countries reduced their aggregate medium- and long-term sovereign exposure to developing countries by $19.1 billion, or 2.6 per cent. This is largely a reflection of two factors.

206. First, pre-existing debt has been removed from bank balance sheets through the Brady initiative, including exchanges for "Brady" bonds, debt for equity swaps and debt retirement. In addition, debt has been similarly removed from bank balance sheets through exchanges, swaps and other mechanisms not related to the Brady plan.

207. Secondly, except under certain conditions, it is the policy of banks to avoid new medium- and long-term sovereign, infrastructure or balance-of-payment loans to countries that have recently rescheduled and to most other developing countries.

208. There is little likelihood that banks will participate in unsecured medium- and long-term lending to developing countries in the near future, other than lending related to foreign trade. Furthermore, given the recent direction of bank regulations regarding capital, asset quality and performance, banks do not view such lending as feasible during the next five years.

(e) The debt burden

209. As observed above, the likelihood of a resumption of significant private inflows to the weaker developing countries is close to nil. In view of the rather bleak prospects for any substantial enhancement of ODA in the near future, the removal of the debt burden on the poorer developing countries takes on special urgency. Provided the projected aid flows are maintained, debt relief increases the cash flow of debt-distressed developing countries, thereby increasing the resources available to them for development.

210. The indebted developing countries face three kinds of creditors: official ones whose claims consist largely of bilateral loans and guaranteed export credits, private commercial banks, and the international financial institutions, notably the IMF, the World Bank and the regional development banks.

211. For some time the idea of debt forgiveness was resisted by donor countries as well as creditors and international financial institutions. As country after country defaulted on payments and the debilitating impact of debt servicing became more obvious, far-reaching proposals for debt relief were put forward by the creditor countries and the international financial institutions. Among them the following may be mentioned:

(a) World Bank's Special Programme of Assistance (SPA) for debt-distressed African countries;

(b) Toronto Principles;

(c) Brady Initiative;

(d) International Monetary Fund's Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF);

(e) Multiyear agreements in the Paris Club;

(f) Proposal made by the Government of the Netherlands at the Second United Nations Conference on the Least Developed Countries, in September 1990;

(g) Proposal of the United Kingdom made at the meeting of Commonwealth Finance Ministers, in Trinidad, in September 1990.

212. A significant feature of these measures has been the gradual acceptance of debt cancellation on a case-by-case basis under certain conditions as a necessary feature of a realistic attack on the issue of the external debt burden on developing countries. Under these measures, some debt relief, including outright cancellation of part of their debt, has been accorded to many debtor countries. In spite of the progress made thus far there is a general consensus that a great deal more needs to be done if debt-distressed developing countries are to retain enough of their foreign exchange receipts to enable them to make up for the reduction in ODA, thereby improving their chances of resuming satisfactory growth.

213. This is a matter of the greatest importance. Increased ODA and real debt relief will increase the resources available to the affected developing countries. Especially in the case of those attempting economic reforms of the sort described above, such increased resources stand a better chance now of being more efficiently used to resume the growth process. Success in this will in turn increase the ability of the affected countries to generate savings and attract and service private inflows of resources, as needed. While this will not remove altogether the value of aid flows to such countries, it will reduce their dependence on such flows for development. It is only in such circumstances that we can see such countries working themselves off aid and exhibiting a more satisfactory growth performance within the international economic environment of the 1990s.

214. Even with improvements in the volume, quality and efficiency of aid flows, the adequacy of net resource flows to the weaker developing countries cannot be assured without a decisive resolution of the problems of external debt.

Box 2

Some examples of the "debt crisis" in historical perspective

The debt crisis that erupted after the announcement by Mexico in 1982 that it was unable to service its commercial bank debts is not without precedent in history. There were widespread debt defaults by sovereign Governments in the 1930s, the 1870s and the 1820s. The crisis of the 1870s involved default on about 54 per cent of the entire amount of foreign governmental obligations listed in London, then the financial capital of the world, while that of the 1930s involved 26 countries, at a time when the League of Nations listed a total of only 55 members.

As with the current crisis, those earlier debt crises followed bouts of unusually large lending to foreign Governments by insufficiently prudent lenders. In like manner, by the end of 1982 nine major United States banks had lent over 287 per cent of their total equity to developing countries.

An examination of a few of the earlier debt crises yields significant insights. In 1867, after the abdication of Emperor Maximilian, the new Mexican Government refused to recognize the loans extended to the Imperial Government by French creditors. The French Government, accepting part of the blame for the loans, although it had not guaranteed them, reimbursed its nationals to the extent of about 50 per cent of the amount they had invested. In 1942 Mexico negotiated an agreement on its external debt with an international committee of bankers, under which bonds were to be redeemed at 20 per cent of their nominal value with a similar reduction in interest. Accrued arrears of interest were to be liquidated at 1 per cent of their face value. In the United States of America, during the nineteenth century, a number of the states of the Union defaulted on their loans. Though many were later settled with drastic reductions in their terms, in other cases, the debts were simply repudiated. Similarly, after the October Revolution in 1917, the new Soviet Government repudiated by decree all debts contracted by the Tsarist and Kerensky regimes.

One major feature of the earlier large-scale debt "settlements" was that creditors and debtor Governments dealt directly with each other, without intervention by the State of the creditor banks. Indeed, there were instances of the State of the creditor banks apologizing for the behaviour of its nationals, as when President Franklin Roosevelt, during a visit by President Penarada of Bolivia, apologized for "some Americans (who had) sold to the Bolivian Government through super salesmanship the idea that it needed a loan".

Another feature was that, because of the scaling-down of the loans, whether unilaterally or through negotiation, the burden of adjustment was shared by creditor banks and debtor Governments, with the result that the debtors acquired external viability and - in many cases, ironically - received enough subsequent credit to become involved in the next major debt crisis.

Two major debt settlement arrangements immediately following the Second World War are particularly instructive in light of the current attitude of creditor countries to the present debt crisis. They were the United States Government loan to the United Kingdom in 1947 and the rescheduling of the post-war foreign debt of the Federal Republic of Germany in 1953.

In the first instance, the United States granted the United Kingdom a loan with the provision that, if in any year interest on the loan amounted to more than 2 per cent of the foreign exchange earnings of the United Kingdom for that year, it was to be waived - not reduced, not deferred, but cancelled.

As to the debt of the Federal Republic of Germany, the United Kingdom and the United States agreed in the London Accord of 1953 to a restructuring by offering holders of the Federal Republic's bonds terms which effectively reduced the outstanding debt by almost 50 per cent: post-war debt was reduced by about 60 per cent, with the United States being the largest contributor; interest rates were reduced by about one fourth; arrears of interest, which had accumulated since 1936, were reduced by about one third; maturities were extended by 10-25 years, typically with six years' grace; and for pre-war debts, the currency of repayment was shifted from gold to dollars, reducing the effective claims by about 40 per cent in dollar terms. It needs to be emphasized that in this exercise, account was explicitly taken of the Federal Republic's reduced circumstances, its capacity to pay, and the need to avoid undue strain on its foreign exchange resources and consequent undesirable effects on its internal financial situation. The aim was to ensure that the Republic could meet its external obligations and return to credit-worthiness as soon as possible. Commercial credit lines were quickly restored, and the country ended up prepaying a large fraction of its restructured debts.

Which developing country today would not relish a loan on terms such as the United Kingdom obtained or a debt settlement like the London Accord of 1953, without the conditionalities of today?

## V. CRITERIA FOR IDENTIFYING LEAST DEVELOPED COUNTRIES

215. The major purpose of constructing a list of countries classified as least developed is to give some guidance to donor agencies and countries about an equitable allocation of foreign assistance. The original criteria used in constructing the list were a blend of structural features that could result in slow growth and the indefinite perpetuation of poverty (unfavourable geographical location, poor climate, small size, undeveloped human resources and inadequate economic infrastructure) and low average income itself. In practice, the list of least developed countries excluded almost all large countries, even though those countries accounted for the majority of the world's poor.

216. The Committee for Development Planning is divided over the question of whether any useful purpose can be served by retaining the classification or whether the criteria used for excluding or including particular countries should be amended. Several members believe that while the list may have been useful 20 years ago, it is less useful today, and perhaps the classification should be discontinued. The General Assembly may wish to reconsider the entire concept of "least developed country".

217. The reason for a reconsideration is that the criteria no longer reflect current thinking on development problems. They characterize features of a country, whereas today the focus has shifted towards people and the characteristics of a country's policies. According to the newer view, the list is no longer useful because aid donors are increasingly thinking in terms of completely different categories when taking decisions about aid allocations: the size of the country is less relevant; the extent of poverty is more relevant.

218. There are also statistical problems. The low quality of available data often makes it difficult to assess accurately the level of average income per head. The data on microcountries, even if accurate, are difficult to interpret or to compare with other countries.

219. Despite the reservations of some members of the Committee about the utility of revising or even retaining a list of least developed countries, considerable thought and effort have been expended on considering how the criteria might be improved, if indeed the General Assembly wishes to continue using the category.

220. The Committee has been reviewing the adequacy of the criteria for identifying the least developed among the developing countries since 1988. The Second United Nations Conference on the Least Developed Countries, held in Paris from 3 to 14 September 1990, which unanimously adopted the Programme of Action for the 1990s for the Least Developed Countries with a view to reactivating and accelerating growth and development in the least developed countries, has given impetus to this work by requesting the Committee to complete its review expeditiously. The Conference endorsed the introduction

of a dynamic element into the application of the criteria and recommended that the completed review and its recommendations be submitted to the Economic and Social Council for consideration and subsequently forwarded to the General Assembly.

221. The original set of criteria for identifying the least developed countries was adopted by the Committee in 1971. 11/ Modifications were made in 1973 12/ and again in 1981. 13/

222. Since 1981, the Committee has recommended countries for inclusion in the list of the least developed countries based on cut-off points for three indicators: upper and lower cut-off points for per capita GDP, 14/ a manufacturing share of 10 per cent or less in total GDP, and a literacy rate of 20 per cent or less. A country would be recommended for inclusion if it satisfied the last two criteria, even if its per capita GDP exceeded the lower cut-off point, as long as it did not exceed the upper cut-off point, or if its per capita GDP fell below the lower cut-off point and it had a manufacturing share of 10 per cent or less in total GDP, even if its literacy rate exceeded 20 per cent.

223. The Committee has long been dissatisfied with these criteria and the ways in which they have been applied and has communicated its dissatisfaction to the Economic and Social Council on several occasions.

224. In the 1980 review of the criteria, a working group of the Committee concluded that the per-capita-income criterion continued to be important but noted that since the quality of the underlying information varied a great deal among countries, the magnitude of per capita GDP had to be viewed as a broad rather than a precise estimate. It expressed strong reservations about the other criteria - namely, adult literacy rate and share of manufacturing in GDP - which were meant to bring out the structural weaknesses of countries. 14/ In 1990 the Committee summed up its position on the issue as follows: "The Committee wished to reiterate - as it had done several times in the recent past - that the existing criteria, which were tentatively formulated some two decades ago under the constraint of a paucity of data on development indicators for developing countries, were not adequate to bring out in a conclusive manner long-term structural weakness which underlay the concept of 'least developed'." 15/

## A. General considerations

225. The Committee attaches importance to a number of considerations in formulating a new set of criteria.

226. The criteria should bring out the salient characteristics of the least developed countries which give rise to special concern for them. Those are - in brief - poverty combined with structural impediments which make it more difficult for them to achieve sustained development without special assistance from the international community.

227. Indicators should be robust so as to minimize the likelihood of easy reversibility from least developed status to non-least developed status and vice versa, as a result of dramatic fluctuations in one or another single

indicator, and should introduce a dynamic element that would serve as a reliable basis for deciding whether countries should be added to, or removed from, the list of least developed countries.

228. The indicators should be those for which reliable data are available on a regular basis. Combinations of indicators serving as criteria should be transparent and easily intelligible and should be consistently applied.

229. The criteria should be formulated so as to lend themselves to a great measure of automaticity in application, but should not be so rigid as to make application mechanical. In the application of the criteria, either for purposes of inclusion or graduation, the Committee would have to exercise judgement, especially in borderline cases.

230. The exercise of judgement on the part of the Committee should be done with the greatest possible transparency and consistency, by adhering to certain pre-established guidelines such as:

(a) Judgement should be based on considerations of poverty and long-term structural impediments and not on short-term set-backs or windfalls;

(b) Additional indicators, also related to the salient characteristics of the least developed, may be examined to form a judgement on particular cases;

(c) Where doubts still persist, in-depth country studies might be requested.

231. The Committee considered the issues of human rights and methods of governance. It recognized the importance of these issues in their own right as well as their relation to economic and social progress. It took the position, however, that it would be inappropriate to use such considerations for decisions regarding inclusion in, or exclusion from, the list of the least developed countries. Many members of the Committee felt, however, that policy performance should be taken into account in a more systematic way.

## B. The criteria

232. The least developed countries shall be defined as those low-income countries that are suffering from long-term handicaps to growth, in particular, low levels of human resource development and/or severe structural weaknesses.

233. The relative level of poverty may be measured by per capita income. A variety of measures of per capita income were considered - per capita GDP, per capita GNP, per capita GDP based on purchasing power parity (PPP) - and although an examination of all of them is recommended, the continued use of per capita GDP (annual average for the latest three years for which data is available) seems still to be most practical.

234. In the view of the Committee, the measurement of human resource development should focus on achievements in health and education as an indication of the capacity of countries to take advantage of opportunities for

development. An augmented physical quality of life index (APQLI), comprising four indicators - life expectancy at birth, per capita calorie supply, combined primary and secondary school enrolment ratio, and adult literacy rate - was considered to be an appropriate measure.

235. As far as structural weakness is concerned, the Committee considered two main kinds of weaknesses: natural handicaps, and low economic diversification. The handicaps - such as having a small population, being geographically isolated (e.g., island countries), being landlocked, or having high risks of climatic disaster - might be measured by an index of instability of agricultural production or by proneness to droughts, floods and cyclones, on a case-by-case basis. Economic diversification might be measured by a composite index (EDI), comprising the share of manufacturing in GDP, the share of employment in industry, per capita electricity consumption, and the export concentration ratio.

236. The Committee decided that, in addition to examining the two proposed composite indices, it would be helpful, particularly in borderline cases, to examine the component indicators that constitute the indexes.

237. Implicit in much of the discussion on least developed countries during the past two decades is the notion that the classification is meant to designate countries of small economic size. The Committee considered that population size should be taken into account explicitly and that countries larger than 75 million inhabitants should not be considered for inclusion on the list.

## C. Application of the criteria

238. The proposed cut-off points on the per capita income indicator and the composite indices and procedures for their application are described below.

239. As for the per capita income criterion, the World Bank cut-off point for low-income countries - measured by GNP plus 10 per cent, to derive an approximate GDP equivalent for less developed countries - is recommended. For 1991 the cut-off point on this basis might be $600 (in 1987), which corresponds roughly to the upper cut-off point of the per capita GDP used by the Committee so far. For additional information, a per capita PPP estimate of GDP, if available, might be used in 1991, equal to or less than $1,000 in 1987. Updated estimates of these measures would be used in subsequent reviews. Countries will be considered for least developed status only if they meet the per capita income and population criteria.

240. Inclusion on the basis of population size, per capita income, human resources and economic diversification should not be automatic but should be subject to a review also of a number of indicators representing structural characteristics affecting the state of and prospects for development of individual countries, including:

(a) The natural endowment index and its component indicators - namely, agricultural land per capita, exports of minerals as percentage of total exports, average rainfall and rainfall variability;

(b) The instability of the agricultural production index or specific climatic risks;

(c) Exports of petroleum as a percentage of total exports;

(d) Official development assistance as percentage of GNP.

241. Benchmarks for the composite indicators were selected by careful examination of how all developing countries ranked on each indicator. The Committee was motivated by three considerations. It sought to choose cut-off points where there were very few countries having nearly identical values; it also felt that the cut-off points should be somewhat lower than the highest values calculated for the low-income countries; finally, it felt that the cut-off points should be chosen in such a way as to minimize changes to the existing list, consistent with the principle of classifying equally disadvantaged countries equally. After examining the data for the two indexes, it decided to set the benchmarks at the third quartile on each index for the low-income countries - i.e., 22 for the EDI and 47 for the APQLI.

242. For those developing countries that meet the per capita GDP criterion and whose population size does not exceed 75 million, eligibility for least developed status will be determined in three stages. First, a core list of least developed countries will be identified among those that fall below the cut-off point on both indexes. Next, the remaining countries will be assessed on the basis of a set of more qualitative indicators - namely, being land-locked, having a small population (1 million or less), being an island (or islands), and having climatic disadvantages - such as proneness to drought, floods, and cyclones - on a case-by-case basis. If any of these countries falls below the cut-off point on either index and is land-locked or an island, or has a population of 1 million or less or suffers from frequent cyclones, droughts and floods, it may be included in the list. At each stage of assessment, the Committee will consider the APQLI or the EDI or both as well as the component indicators of the indexes. Moreover, in borderline cases, consideration of the additional structural characteristics mentioned above will be considered.

243. If the assessment of eligibility on the basis of the above criteria and procedures turns out to be inconclusive with regard to one or more countries, the Committee might commission in-depth country studies before reaching a definitive conclusion.

244. The above procedures constitute the inclusion rules, which apply only to countries that are not currently on the list of the least developed countries. For countries that are already on the list the graduation rule as set out below will apply.

245. The Committee recommends that a country should be considered no longer eligible for least developed status when it has exceeded the cut-off point on the per capita income criterion relevant at the time the review was carried out and the cut-off point on either the APQLI or the EDI for at least three years. The margins by which the cut-off points need to be exceeded may be set at $100 on per capita income, 5 points on the APQLI and 3 points on the EDI. A country might also be graduated from the list if it exceeded the cut-off

points by the margins indicated for both indexes even if per capita income remained below the cut-off point.

246. The Committee believes that a general review of the list of the least developed countries should be made by the Committee once every three years, preferably in the second year of each new Committee. The review should include all low-income countries - i.e., those with per capita GDP below the per capita GDP criterion at the time of the review. Thus, it would not normally be necessary for countries to request their inclusion in the list.

## D. Recommendations

247. On the basis of the criteria and their application the Committee has assessed the eligibility of countries as described below. At the first stage, countries were considered on the basis of per capita GDP, APQLI and EDI. The following 35 countries shown in group I (see table 4) meet all four criteria: Afghanistan, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Djibouti, Equatorial Guinea, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Liberia, Madagascar, Malawi, Mali, Mauritania, Nepal, Niger, Rwanda, Sao Tome and Principe, Sierra Leone, Solomon Islands, Somalia, Sudan, Togo, Uganda, United Republic of Tanzania, Zaire, Zambia.

248. Of this total of 35 countries, seven - namely, Cambodia, Ghana, Kenya, Madagascar, Solomon Islands, Zaire and Zambia - are not currently on the list of the least developed countries. However, among those countries Kenya is right on the cut-off point on the EDI and Madagascar is on the cut-off point on the APQLI. Those two countries are both of medium size. Kenya suffers from frequent droughts, and Madagascar is prone to cyclones and droughts. The Committee considers those countries to be borderline cases, Madagascar having a stronger case for inclusion than Kenya. On balance, the Committee therefore recommends the inclusion of Madagascar but not of Kenya.

249. The second stage of assessment was based on the APQLI and the other indicators relevant for countries in group II. Two countries - namely, Haiti and Mozambique - are eligible, since they both meet the per capita GDP criterion and the APQLI (but not the EDI) criterion. Both are already on the list and should be retained, since they do not meet the graduation rule.

250. The third stage of assessment was based on the EDI and the other indicators relevant for countries in group III. Five countries - namely, Kiribati, the Lao People's Democratic Republic, Lesotho, Maldives and Tuvalu - are eligible on these considerations. They all meet the per capita GDP criterion and the EDI (but not the APQLI) criterion. Moreover, Kiribati, Maldives and Tuvalu are islands with very small populations; Lesotho is land-locked; and Lao People's Democratic Republic is land-locked and also suffers from frequent droughts and floods. Again, since these countries are already on the list, they should be retained since they do not meet the graduation rule.

Table 4. Criteria for identifying the least developed countries

| Country | Per capita GDP (United States dollars), annual average, 1987-1989 | APQLI a/ | EDI b/ |
|---|---|---|---|
| | Countries with per capita GDP of $600 or less, population of 75 million or less, APQLI of 47 or less and EDI of 22 or less | | |
| Afghanistan | 276 | 17 | 19 |
| Benin | 385 | 26 | 18 |
| Bhutan | 195 | 27 | 20 |
| Burkina Faso | 200 | 16 | 17 |
| Burundi | 215 | 27 | 8 |
| Cambodia c/ | 82 | 44 | 21 |
| Central African Republic | 375 | 28 | 18 |
| Chad | 177 | 18 | 15 |
| Comoros | 431 | 44 | 8 |
| Djibouti | below 400 d/ | 15 | 15 |
| Equatorial Guinea | 400 | 32 | 14 |
| Ethiopia | 120 | 19 | 14 |
| Gambia | 313 | 26 | 16 |
| Ghana c/ | 360 | 42 | 19 |
| Guinea | 435 | 17 | 4 |
| Guinea-Bissau | 174 | 31 | 15 |
| Kenya c/ | 375 | 44 | 22 |
| Liberia | 474 | 32 | 14 |
| Madagascar c/ | 149 | 47 | 19 |
| Malawi | 171 | 26 | 17 |
| Mali | 233 | 16 | 13 |
| Mauritania | 466 | 28 | 13 |
| Nepal | 131 | 30 | 22 |
| Niger | 305 | 18 | 9 |
| Rwanda | 327 | 26 | 9 |
| Sao Tome and Principe | 430 | 46 | 10 |
| Sierra Leone | 289 | 18 | 21 |
| Solomon Islands c/ | 566 | 23 | 21 |
| Somalia | 216 | 9 | 9 |
| Sudan | 302 | 26 | 21 |
| Togo | 389 | 37 | 18 |
| Uganda | 231 | 35 | 3 |
| United Republic of Tanzania | 127 | 35 | 19 |
| Zaire c/ | 95 | 41 | 22 |
| Zambia c/ | 367 | 45 | 14 |

Table 4 (continued)

| Country | Per capita GDP (United States dollars), annual average, 1987-1989 | APQLI a/ | EDI b/ |
|---|---|---|---|
| | Countries with per capita GDP of $600 or less, population of 75 million or less, APQLI of 47 or less but EDI of 22 | | |
| Haiti | 358 | 34 | 28 |
| Mozambique | 78 | 24 | 24 |
| | Countries with per capita GDP of $600 or less, population of 75 million or less, EDI 22 or less, but APQLI above 47 | | |
| Kiribati | 405 | 73 | 3 |
| Lao People's Democratic Republic | 178 | 53 | 21 |
| Lesotho | 240 | 51 | 18 |
| Maldives | 441 | 50 | 18 |
| Tuvalu | 245 | 65 | 19 |
| | Countries with per capita GDP of $600 or less, population of 75 million or less, but APQLI APQLI above 47 and EDI above 22 | | |
| Guyana c/ | 386 | 69 | 23 |
| Myanmar | 218 | 57 | 24 |
| Nicaragua c/ | 393 | 61 | 25 |
| Viet Nam c/ | 119 | 58 | 25 |
| | Countries with per capita GDP of $600 or less but population greater than 75 million | | |
| Bangladesh | 202 | 27 | 22 |
| China c/ | 291 | 68 | 34 |
| India c/ | 328 | 42 | 31 |
| Indonesia c/ | 477 | 58 | 22 |
| Nigeria c/ | 230 | 35 | 5 |
| Pakistan c/ | 366 | 31 | 29 |

Table 4 (continued)

| Country | Per capita GDP (United States dollars), annual average, 1987-1989 | APQLI a/ | EDI b/ |
|---|---|---|---|
| | Countries currently classified as least developed with per capita GDP above $600 | | |
| Botswana | 1 625 | 52 | 12 |
| Cape Verde | 741 | 49 | 17 |
| Samoa | 748 | 68 | 14 |
| Vanuatu | 881 | 48 | 14 |
| Yemen | 663 | (29 e/ | (14 e/ |
| | | (34 b | ( 6 f/ |

Note: Inclusion rule. A country will qualify for inclusion if it meets all four formal criteria - namely, population size, per capita income, the APQLI and the EDI, subject to the judgement of the Committee on the natural endowment index and its component indicators, exports of petroleum as a percentage of total exports and official development assistance as a percentage of GNP; or if it meets the population and per capita income criterion, and the APQLI or the EDI and is land-locked, is a small country with a population of 1 million or less, suffers from frequent severe climatic risks such as drought, floods and cyclones. Inclusion will be subject to the judgement of the Committee on other considerations.

Graduation rule. A country will be graduated from the list if it has exceeded the cut-off point on the per capita income criterion relevant at the time a review is carried out and the cut-off point on either the APQLI or the EDI for three years, or if it has exceeded the cut-off points on both the APQLI and the EDI, even if its per capita income remained below the cut-off point on the per capita income criterion. The margins by which the cut-off points need to be exceeded are set at $100 per capita income, 5 points on the APQLI and 3 points on the EDI.

a/ Augmented physical quality of life index, comprising life expectancy at birth, per capita calorie supply, combined primary and secondary school enrolment, and adult literacy rate.

b/ Economic diversification index, comprising the share of manufacturing in GDP, the share of employment in industry, per capita electricity consumption, and the export concentration ratio.

c/ Not on the current list.

d/ Estimated per capita GDP accruing to Djiboutians.

e/ For the former Yemen Arab Republic.

f/ For the former People's Democratic Republic of Yemen.

251. Four countries - namely, Guyana, Myanmar, Nicaragua and Viet Nam (group IV) - have a per capita GDP well below the cut-off point on the per capita GDP criterion but did not meet either the APQLI or the EDI. Myanmar, which is already on the list, does not yet meet the graduation criteria, and the Committee recommends that it be retained.

252. Six countries have a per capita income below $600 but have a population size greater than 75 million (group V). Of these countries, only Bangladesh is at present on the list. Since it does not meet the graduation rule, the Committee recommends that it be retained.

253. The foregoing assessment was made for low-income countries, defined for present purposes as those whose per capita GDP fell below the cut-off point on the per capita GDP criterion. The per capita GDP of five countries currently on the list of least developed countries (group VI) - namely, Botswana, Cape Verde, Samoa, Vanuatu and Yemen - exceeded the cut-off point on the per capita GDP criterion and have been assessed separately in the light of the graduation rules proposed.

254. It should be noted that the Yemen Arab Republic and the People's Democratic Republic of Yemen have been kept separate for purposes of this exercise because integrated data on all the indicators used are not yet available for the unified country, Yemen. At any rate, Yemen should be retained since both the former Yemen Arab Republic and the People's Democratic Republic of Yemen meet both the APQLI and the EDI, and their combined annual average per capita GDP for the period 1987-1989 is estimated at $674. The country, therefore, does not meet the graduation rule.

255. Cape Verde, Samoa and Vanuatu are all micro States and islands. All of them have very low values for the EDI. Cape Verde and Vanuatu are marginally above the cut-off point on the APQLI, much less than required for purposes of graduation. Samoa, however, is well above it. The current per capita GDP of all three countries is well above the cut-off point on the per capita GDP criterion, and they are also above the $100 margin above the cut-off point required for graduation. In the case of Cape Verde, however, the current level of per capita GDP is a result of strong currency appreciation starting in 1986, which is to say that the current level may be unrealistic and has been that high for only a few years. All three countries are recipients of substantial official development assistance. In the period 1970-1987, ODA as a percentage of GDP is estimated, on average, to have been 25.3 for Samoa, 51.2 for Vanuatu and 60.0 for Cape Verde. This suggests that the levels of incomes in these countries have for a long time been dependent on external assistance, without which they could not be sustained. While it is the case that such high levels of ODA are typical for very small countries and do not directly affect the calculation of GDP measured in local currency units, it is also true that their exchange rates are influenced by such flows. In the absence of such flows, their exchange rates (units of local currency per United States dollar) would be higher and their GDP, expressed in United States dollars, lower. At any rate, Cape Verde and Vanuatu do not meet the graduation rule. In conclusion, the above considerations indicate that all three countries should be retained on the list. The remaining country, Botswana, satisfies the graduation rule and should be removed from the list.

256. In conclusion, the Committee recommends that all the countries currently on the list of the least developed countries be retained, except Botswana, and that six new countries - namely, Cambodia, Ghana, Madagascar, Solomon Islands, Zaire and Zambia - be included in the list. Counting the former Yemen Arab Republic and the People's Democratic Republic of Yemen as one country (Yemen), as is the case now, there will be 47 countries on the list of the least developed countries. It should be noted that the recommended list will have important implications for the Programme of Action in the 1990s for the Least Developed Countries in general and for the ODA targets agreed therein.

## E. Future work

257. The Committee requests the Secretariat to maintain up-to-date data on the relevant indicators and table the data sheets at every annual meeting of the Committee so as to enable the Committee to take note of emerging trends in the indicators.

258. If trends in the indicators of countries on the list presage alteration of the list, appropriate consultations shall be undertaken in preparation for the triennial review.

259. The Committee wishes to acknowledge the valuable contributions made by the United Nations Conference on Trade and Development, and the United Nations Development Programme, and emphasizes the need for continued cooperation between the Committee secretariat and those two bodies.

## VI. OTHER MATTERS

### A. Identification of the least developed among the developing countries: Namibia

260. At the request of the General Assembly (resolution 45/198), the Committee examined the case of Namibia for inclusion in the list of least developed countries, both on the basis of the existing criteria and on the basis of the revised criteria.

261. Following the practice established in earlier reviews, the Secretariat provided the Committee with information necessary to update the per capita GDP criterion for changes in prices and the real growth of per capita GDP in world market economies. The adjusted lower and upper cut-off points of the per capita GDP criterion were found to be $515 and $618, respectively. The Secretariat also supplied the Committee with the most recent available data pertaining to Namibia and the criteria - namely, per capita GDP, the share of manufacturing in GDP, the rate of adult literacy and the composite indicators: augmented physical quality of life and economic diversification.

262. The Committee reviewed this information as well as the material submitted by the Government of Namibia. The available information revealed the following features of the economy. The country is highly endowed with considerable natural resources, especially minerals, which comprise between 75 and 80 per cent of merchandise exports. Diamonds account for about 40 per cent of total mineral exports. In 1989 agricultural exports accounted for 11 per cent of total exports and manufactures for 5 per cent. Average GDP per capita for 1987-1989 as estimated by various sources is thought to be in the range of $960 to $1,450. The share of manufacturing value added in GDP is estimated to be less than 5 per cent. The adult literacy rate is estimated to be at least 30 per cent. Values for the composite indices were 34 and 28 for the APQLI and the EDI, respectively. The Committee took note of the fact that the income distribution of the country is highly skewed and that the average per capita income of the non-white population engaged in traditional activities could be as low as $65. The Committee also took note of the fact that, as a newly independent nation, Namibia encountered special problems in its present transitional period.

263. The Committee concluded that Namibia did not meet the existing criteria based on the current procedures for their application, due primarily to the relatively high GDP per capita. It also concluded that Namibia did not meet the revised criteria because of its GDP per capita, its natural endowments and the level of the economic diversification index. The Committee none the less recommends that the international community adopt special measures in favour of Namibia for a period of years in order to assist it in mobilizing its considerable economic potential as a newly independent nation.

## B. Contribution to the high-level meeting of the Economic and Social Council

264. The Committee considered that its analysis of economic reform in Eastern Europe and the USSR and the impact of that reform on developing countries was relevant to the major policy theme selected by the Council for 1992. The Committee endorsed the agreement reached in its self-evaluation conducted at its twenty-sixth session - namely, "that its Chairman or another member of the Committee designated by him could address the Economic and Social Council at its summer session and introduce its report, especially when it took up matters relating to a major policy theme of the Council". 16/

## VII. ARRANGEMENTS FOR FUTURE WORK

### A. Work programme for the twenty-eighth session (1992)

265. The Committee agreed on the indicative two-year work programme outlined below and decided to prepare for its twenty-eighth session (New York, 20-24 April 1992) through three working groups, supported by relevant studies to be undertaken by the Secretariat and independent experts on the selected themes.

266. The Committee stressed the need for intensive substantive preparations before the regular sessions, including the work of consultants as well as the Secretariat, and was informed by the Secretariat that its proposed work programme could be carried out within the current budgetary appropriations.

267. The Chairman, Abdlatif AL-HAMAD, recalled his invitation, extended at the twenty-sixth session, to hold the plenary session of the Committee in Kuwait, and he expressed his regrets that recent events had made this impossible. If it should later prove possible, he intended to ask the Committee to consider changing the venue of the twenty-eighth session from New York to Kuwait.

#### 1. World economic outlook, 1992-1996

268. The Committee intends at its next session to conduct a more extensive analysis of trends and prospects for the world economy. This will enable it to provide a context for its more detailed work on economic reforms in developing countries and on poverty, environment and development (see below) as well as to compare at an early stage the actual performance of the world economy against the objectives of the International Development Strategy. Special attention will be given to two topics: the progress of economic reforms in Eastern and Central Europe, and changes in the international trading environment and the outcome of the GATT negotiations.

269. The Committee proposed to look into these and other related issues by convening a representative working group of from five to eight members and technical experts, chaired by George Suranyi (Geneva, 5-7 February 1992).

#### 2. Economic reform in developing countries

270. Beset by internal and external imbalances arising from a combination of large external shocks and policy shortcomings, many developing countries have been implementing economic reforms. The Committee intends to examine the political economy of the policy reform process, paying particular attention to reform efforts in sub-Saharan Africa and the socialist countries of Asia. The focus of analyses will be, first, on the ways adjustment measures or policies implemented during the transition from one policy regime to another affect the level of investment and the efficiency of capital utilization and hence the rate of economic growth. The intention is to consider how short- and medium-term policies are linked to longer-term prospects. Secondly, the Committee will examine the effect of economic forces unleashed during a reform process upon the distribution of income and the incidence of poverty.

271. In comparing the experience of different countries, the Committee intends to examine the interrelationships among human rights, participation, the accountability of Governments to the governed, and democracy. The Committee hopes in this way to make a contribution to the World Conference on Human Rights, scheduled for 1993.

272. The Committee proposed to study these issues of reform in developing countries through a working group of from five to eight members, including technical experts, to be chaired by Ademola Oyejide (New York, 19-22 November 1991).

### 3. Poverty, environment and development

273. Massive rural poverty in many parts of the world is both a cause and consequence of environmental degradation. Serious damage to the environment is occurring because of overgrazing, overcultivation of land without replenishment of soil nutrients, deforestation and excessive use of ground-water supplies. In many areas of the world, desertification is spreading and the increasing incidence and the intensity of floods are having enormous adverse effects on livestock, crops and infrastructure and on human beings. The rural poor, pushed into marginal land and deprived of resources, often have little alternative but to overexploit the natural environment. At the same time the weakening of communal institutions designed to manage land, forests and water resources in the common interest and their replacement by seemingly more modern institutions have sometimes led to accelerated deterioration.

274. Modern institutional development and the accompanying intensification of agriculture has sometimes been associated with careless use of pesticides and herbicides and excessive use of fertilizers and that, in turn, has aggravated problems of water pollution. Similarly, mismanagement of large irrigation schemes has led to water-logging, salination and alkalination on many hectares of land throughout the developing world.

275. The consequences of environmental deterioration also are serious for many millions of people living in the urban areas of developing countries. Industrial development has been accompanied by air and water pollution, through the emission of pollutants and the disposal of hazardous waste into streams, lakes, oceans and the air. The Committee proposes to examine issues related to poverty, the environment and development, using (and clarifying) the concept of sustainable development. It hopes thereby to contribute to the United Nations Conference on Environment and Development, to be held in Rio de Janeiro in 1992.

276. The Committee proposed to study these issues through a working group of from five to eight members, including technical experts, and chaired by Udo Simonis (Geneva, 8-11 October 1991).

## B. A provisional work programme for the twenty-ninth session (1993)

277. The Committee decided to consider at its twenty-ninth session the issue of population growth in relationship to natural resources, environment and development. It hoped in this way to contribute to the consideration of the major policy themes selected by the Council in the context of a high-level special meeting in 1993 and to the International Conference on Population in 1994. It agreed to propose terms of reference for a working group on this subject and to decide on other themes at a later date.

## VIII. ORGANIZATION OF THE SESSION

278. The twenty-seventh session of the Committee for Development Planning was held at United Nations Headquarters from 22 to 26 April 1991. Twenty-three members of the Committee attended: Abdlatif AL-HAMAD; Gerassimos ARSENIS; Edmar BACHA; P. N. DHAR; Just FAALAND; Ricardo FFRENCH-DAVIS; Tchaboure GOGUE; Keith GRIFFIN; Patrick GUILLAUMONT; Mahbub UL HAQ; Ryokichi HIRONO; Helen HUGHES; Nicolai LIVENTSEV; Solita MONSOD; Henry NAU; Maureen O'NEIL; T. Ademola OYEJIDE; Shan PU; Akilagpa SAWYERR; Udo Ernst SIMONIS; George SURANYI; Miguel URRUTIA; Ferdinand VAN DAM. Karel DYBA did not attend.

279. The officers elected at the twenty-sixth session for the term ending on 31 December 1992 were:

| | |
|---|---|
| Chairman: | Abdlatif Y. AL-HAMAD |
| Vice-Chairmen: | Edmar BACHA<br>Just FAALAND<br>T. Ademola OYEJIDE |
| Rapporteur: | Keith GRIFFIN |

280. The session was opened by the Under-Secretary-General for International Economic and Social Affairs, Mr. Rafeuddin Ahmed. Mr. Ahmed expressed to the Chairman, Abdlatif Al-Hamad, his sympathy for the tragic events which had struck Kuwait and his hopes for a speedy recovery for the whole region. He went on to speak about the relevance to the high-level meeting of the Economic and Social Council, planned for July 1991, of the Committee's analysis of the impact of reform in Eastern Europe and the USSR on developing countries. He noted that developments in those countries - together with the Gulf crisis - had added to recessionary trends in the world economy. In the medium term, he observed that the ways in which developed market economies sought to underpin the reform efforts could make it more difficult for developing countries to achieve the aims of the International Development Strategy if, for example, those led to a significant diversion of official development finance away from developing countries or to persistently higher real interest rates in world financial markets. He also commended the Committee for its work on international financial cooperation for development and its efforts to develop improved criteria for the identification of the least developed among the developing countries.

281. Preparation for the session had been carried out by three working groups of the Committee. The working group on reform in socialist countries (Geneva, 27-30 November 1991) consisted of Nicolai LIVENTSEV (Chairman), Ferdinand VAN DAM (Rapporteur) and Shan PU. Its work was further supported by a collection of consultants' reports financed by a special grant provided by the Government of the Netherlands. First drafts of those studies were discussed at a symposium attended by the members of the working group and hosted by the Ministry of Foreign Affairs of the Government of the Netherlands (The Hague, 20-22 February 1991). The working group on international financial cooperation for development (New York, 5-8 February 1991) consisted of Just FAALAND (Chairman), Akilagpa SAWYERR (Rapporteur), Patrick GUILLAUMONT, Tchaboure GOGUE, Solita MONSOD, Henry NAU and

Maureen O'NEIL. The working group's deliberations on criteria for identifying the least developed countries were facilitated by a report by the UNCTAD secretariat, "Meeting of experts on criteria for identifying the least developed among the developing countries", held under UNCTAD auspices (New York, 30-31 January 1991). 17/ The working group on the International Development Strategy and national policies (New York, 1-3 November 1989) consisted of Edmar BACHA (Chairman), Gerrasimos ARSENIS (Rapporteur), Patrick GUILLAUMONT, Henry NAU and Mahbub UL HAQ with Augustine NYAMATORE, Rahman SOBHAN, Miguel URRUTIA and Rogelio WERNECK as co-opted experts.

282. Substantive services for the session were provided by the Department of International Economic and Social Affairs of the United Nations Secretariat. The following bodies were represented at the session: the Centre on Transnational Corporations, the United Nations Children's Fund, the United Nations Conference on Trade and Development, the United Nations Development Programme, Department of Technical Cooperation for Development of the United Nations Secretariat, the United Nations Office at Vienna, the United Nations Environment Programme, the United Nations University, the Economic Commission for Africa, the Economic and Social Commission for Western Asia, the United Nations Centre for Human Settlements, the International Atomic Energy Agency, the World Food Council, the World Food Programme, the International Labour Organisation, the Food and Agriculture Organization of the United Nations, the World Health Organization, the World Bank, the International Monetary Fund, the United Nations Industrial Development Organization, the United Nations Institute for Training and Research, the United Nations Educational, Scientific and Cultural Organization, and one non-governmental organization.

## Notes

1/ The Committee reviewed recent short- and medium-term projections of the world economy emanating from the work of Project LINK. See "World economic situation and prospects, 1991-1995: Report of the Meeting of the Expert Group on Short- and Medium-term Projections of the World Economy" (Project LINK). Occasional Paper No. 4.

2/ This section draws heavily on a paper prepared for the Department of International Economic and Social Affairs, United Nations Secretariat, by Kazimierz Poznanski, "The economic reforms in East Europe and trade prospects for developing nations" (mimeo, 1991).

3/ Cited in a paper prepared for the Department of International Economic and Social Affairs, United Nations Secretariat, by Roger Young (North-South Institute), "Official financing for development: the implications of reforms in eastern Europe" (mimeo, April 1991).

4/ Organisation for Economic Cooperation and Development, Development Cooperation 1990 Report (Paris, December 1990), p. 11.

5/ This section draws heavily on a paper prepared for the Department of International Economic and Social Affairs, United Nations Secretariat, by Carl McMillan, "Foreign direct investment flows to Eastern Europe and their implications for developing countries" (mimeo, April 1991).

6/ This section draws heavily on a paper prepared for the Department of International Economic and Social Affairs, United Nations Secretariat, by Hans Eckart Scharrer, "The impact of German unification on international financial markets" (mimeo, April 1991).

7/ Growth rates of GDP, savings and investments are based on the data files of the United Nations Department of International Economic and Social Affairs, United Nations Secretariat.

8/ General Assembly resolution 45/199 of 21 December 1990, annex, para. 13.

9/ Ibid., para. 37.

10/ Official Records of the Economic and Social Council, 1990, Supplement No. 7 (E/1990/27).

11/ Ibid., 1971, Supplement No. 7 (E/4990), chap. II.

12/ See ibid., 1973, Supplement No. 5 (E/5293), p. 31.

13/ See "Report of the Working Group of the Committee for Development Planning on the Identification of the Least Developed Among the Developing Countries" (14 November 1980), pp. 6-7; and Official Records of the Economic and Social Council, 1981, Supplement No. 7 (E/1981/27), p. 27.

14/ These were $473 and $567 in 1990, based on a three-year average for the years 1985-1987. The benchmarks have been regularly updated by the growth rate of nominal GDP per capita in world market economies.

15/ See Official Records of the Economic and Social Council, 1990, Supplement No. 7 (E/1990/27), p. 46.

16/ Ibid., para. 155.

17/ TD/B/1290-TD/B/AC.17/37.

## Annex I

### AGENDA

1. Adoption of the agenda.

2. The world economic outlook, 1991-1995.

3. Reform in socialist countries and consequences for the developing countries: report of Working Group I.

4. International financial cooperation for development: report of Working Group II.

5. Criteria for the identification of least developed countries: report of Working Group II.

6. Identification of the least developed countries: the case of Namibia.

7. Work programme for the twenty-eighth session.

8. Other matters.

## Annex II

### LIST OF THE LEAST DEVELOPED AMONG THE DEVELOPING COUNTRIES

| | Country | Date of inclusion in the list |
|---|---|---|
| 1. | Afghanistan | 1971 |
| 2. | Benin | " |
| 3. | Bhutan | " |
| 4. | Botswana a/ | " |
| 5. | Burkina Faso | " |
| 6. | Burundi | " |
| 7. | Chad | " |
| 8. | Ethiopia | " |
| 9. | Guinea | " |
| 10. | Haiti | " |
| 11. | Lao People's Democratic Republic | " |
| 12. | Lesotho | " |
| 13. | Malawi | " |
| 14. | Maldives | " |
| 15. | Mali | " |
| 16. | Nepal | " |
| 17. | Niger | " |
| 18. | Rwanda | " |
| 19. | Samoa | " |
| 20. | Somalia | " |
| 21. | Sudan | " |
| 22. | Uganda | " |
| 23. | United Republic of Tanzania | " |
| 24. | Yemen b/ | " |
| 25. | Bangladesh | 1975 |
| 26. | Central African Republic | " |
| 27. | Gambia | 1975 |
| 28. | Cape Verde | 1977 |
| 29. | Comoros | " |
| 30. | Guinea Bissau | 1981 |
| 31. | Djibouti | 1982 |
| 32. | Equatorial Guinea | " |

| | Country | Date of inclusion in the list |
|---|---|---|
| 33. | Sao Tome and Principe | " |
| 34. | Sierra Leone | " |
| 35. | Togo | " |
| 36. | Vanuatu | 1985 |
| 37. | Tuvalu | 1986 |
| 38. | Kiribati | " |
| 39. | Mauritania | " |
| 40. | Myanmar | 1987 |
| 41. | Mozambique | 1988 |
| 42. | Liberia | 1990 |

The Committee recommends that the following countries be added to the list, subject to the approval of the General Assembly:

Cambodia

Ghana

Madagascar

Solomon Islands

Zaire

Zambia

## Notes

a/ To be removed from the list, subject to the approval of the General Assembly.

b/ Yemen Arab Republic, 1971; People's Democratic Republic of Yemen, 1975; the two countries were united in 1990.

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